THE INDIAN PUBLIC DEBT

(A critical study of the borrowing policy of the Government of India in recent times)

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WITH A FOREWORD

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FOREWORD

I HAVE great pleasure in commending this book on "War and Post-War Public Debt of India" to the attention of all those who are interested in public affairs in this country.

It provides a thorough study and lucid explanation of the whole subject; and I have been impressed with the author's clear desire to present a true picture, and with the fairness of his statement of the case, even on points where I might be unable myself entirely to endorse his opinions. Professor Dubey has performed a valuable service to his country in producing this study of so important a subject, and in setting an example of accurate and detailed investigation into those economic questions which so deeply concern the welfare of India.

I hope that his book will be widely read and wish Dr. Dubey himself great success not only with this work but in his future career.

"Peterhof," Simla
September 9th, 1930

GEORGE SCHUSTER

PREFACE

THE Public Debt of India has of late received a considerable amount of popular attention and come in for a great deal of comment from different quarters. The presentation of a dispassionate survey of the subject from a scientific and detached point of view would not, I believe, be inopportune at the present moment, and may, on the other hand, prove of some help in the solution of some of the outstanding problems connected with the subject.

For nearly two years I studied at close quarters the conditions in the London Money Market and utilized every opportunity to obtain first-hand information on the subject and to discuss my views with those actually engaged in this branch of business in "the City." I had also a few occasions to exchange notes on the subject with those who had served in the highest capacities in the Finance Department of the Government of India and a few high-placed officials of the British Treasury. My thanks to them all.

I am specially grateful to Dr. G. Slater under whose principal guidance this research was carried on, for the great personal interest that he always evinced in my work. I am also beholden to Dr. Dalton (late of the London University and now Under-Secretary for Foreign Affairs in the Labour Government) and Prof. L. Robbins of the London

School of Economics for the invaluable suggestions that I received from them from time to time during the course of my investigations.

I desire here to acknowledge the help that I received from a personal friend of mine, Mr. D. D. Bharadvaja, of *The Leader*, Allahabad, who is responsible for many of the sub-headings. His suggestive criticisms based on his journalistic experience enabled me to do a considerable amount of regrouping of the subject-matter.

Last but not the least, I must express my high sense of gratitude to the Hon. Sir George Schuster, Finance Member of the Government of India, who amidst his numerous pre-occupations, just on the eve of his departure for England, managed to find time to go through the MSS. and write a few lines as foreword in appreciation of my work.

MEERUT COLLEGE D. L. DUBEY
September 20th, 1930

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The equivalent of a Lakh is—100,000

The equivalent of a Crore is—10,000,000

CHAPTER I

GENERAL FEATURES OF THE INDIAN PUBLIC DEBT

A DISTINGUISHED authority on public finance has observed that the rise of public debts in modern times is an outcome of the development of democratic forms of government. This does not necessarily imply that the democracies of the world have rightly used the institution of public credit for the purpose of promoting the material welfare of the populations of their respective countries. A perusal of any Memorandum on Public Finance issued by the League of Nations in recent years would show that public debts of almost all the important countries of the world to-day consist largely of deadweight loads due to wars, preparations for wars or the aftermath of wars. Newer countries, and especially the British Dominions and other parts of the oversea Empire, are, however, somewhat better in this respect. The use of public credit for the creation of productive assets and the development of the material resources of the countries concerned is an important characteristic of the oversea parts of the British Empire, and speaks volumes for the

financial genius of the British race, for the way in which foreign investments have been built up. Britain is still the most important investor in foreign countries, in fact a full hundred per cent ahead of America in that respect,[1] and has foreign investments of about £4,000 million abroad, from which she enjoys an income of about £275 million to £300 million a year.[2] A remarkable organization has been evolved at home in order to raise long-term funds for investment in the Dominions, in the Colonies, Dependencies, Protectorates, Mandated Territories, and territories with spheres of influence which make up the modern Empire, in countries in which the British themselves were pioneers in industrial enterprise, as well as in other economically and politically backward, half-developed and fully independent countries. A healthy flow of funds to provide for the occasional renewal or extension of capital invested abroad is assured from the headquarters of the mother country. The types of investments are as diversified as their location; the eggs are

[1] *Vide* the Harris Foundation Lectures on "Foreign Investments" at the University of Chicago by H. K. Norton and others, where the former stated that America had built over $9,000 million foreign investments during and since the war.

[2] *Vide* Kimber's "Government Debts."

very far from being in one basket. The wide range of destination of the capital mobilized in London includes shipping, banking, insurance, mining, plantations, transport, lighting, many forms of industrial activity, as well as investments in Governmental and Municipal securities.

India's Foreign Indebtedness.—India's share in these investments comes to a sixth of the total. Two recent estimates of the total British investments in India put them at £583 million and £700 million respectively.[1] Our own figure, calculated by taking Prof. Keynes' estimate of £350 million in 1909 as the basis, and adding to it the obligations incurred since then, indicates a total which may be placed cautiously at £600 million.

	£ m.
Prof. Keynes' Estimate, 1908	350
Total net Governmental (£121 m.), Municipal (£12 m.) and business (£66 m.) issues made since 1908	200
Liability for the remainder of the British Government war loan	17
Allowance for increase in registered rupee capital in India	25
Discounts and conversions in London ...	8
Total Investments ...	600

[1] *Financial Times*, £583 m.; *Economist*, February 22nd, 1930, £700 m.

This amount of £600 million may be regarded as the foreign indebtedness of India as a whole. Out of this sum, the direct sterling obligations of the Government of India in all forms amount to roughly £358 million, their guarantee on the Railway Debentures to another £14 million, and the sterling debts of the local bodies to £13 million. Thus the public bodies in India control nearly two-thirds of the foreign capital invested in the country. So far as the question of adjusting the payment of remuneration for the employment of foreign capital in India is concerned, it makes no difference whether the capital is controlled by official or non-official agencies. The foreign investor in Indian securities, whether residing in England or domiciled in India—or plying on the high seas, for that matter—whether holding Railway Debentures, or Government Stock, or shares in the jute mills or tea plantations, possesses a claim on the goods and services of the country for an annual dividend on his investment and the final redemption of his capital so long as his investment continues.

But there are certain other considerations on account of which foreign investments under official control are considered better in the interests of the debtor country as a whole than

those made by individual investors in private or joint stock enterprise. According to the classification of foreign capital made recently by Dr. Gilbert Slater,[1] State and Municipal loans, bonds of port authorities, bonds and debentures of private companies, and bank loans are "investments in which the external investor is merely entitled to a rate of interest and acquires rights of control only when there is default." This class of investment, according to Dr. Slater, "has been largely necessary in the past and is on the whole unobjectionable in the present."[2] The force of the argument raised by Dr. Slater can be well illustrated by reference to some figures given by the Acworth Committee (1921) with regard to capital investments in Indian Railways. The committee stated that for the last forty-five years the net earnings of the capital invested in Indian Railways, a considerable portion of which has been supplied from London, had never sunk below 4 per cent, and that during the previous twenty years they had only three times sunk below 5 per cent in spite of the fact that a substantial sum had been charged against revenue for repayment of

[1] In his evidence in reply to the questionnaire issued by the External Capital Committee of 1925.

[2] External Capital Committee Report, p. 8.

capital, while not an inconsiderable part of the total mileage had been built for strategic and not for commercial purposes. The average rate payable by the Government of India on their borrowed money was about $3\frac{3}{4}$ per cent.[1] The rest of the percentage dividend on the investment, therefore, went to the relief of the taxpayer. In the case of the privately-controlled capital, of course, all the profits made in the enterprise go into the pockets of the investor. For instance, the National Bank of India, incorporated in England, has a paid-up capital of £2 million employed in India, and profits are made by the Bank to the extent of 20 per cent on the working capital. The whole of this dividend being the unrestricted property of the shareholders, must be distributed among them as their annual profit. This is one of the reasons why foreign capital when it enters into competition with indigenous enterprise, raises questions of its control by the nationals of the country.

In the case of officially-controlled capital, the surplus profits, after the payment of a regular fixed rate of interest to the investor, remain available for the community as a whole. It is a

[1] Cmd. 1512, 1921, para 63.

well-known fact in London that foreign investments in private enterprise yield higher returns than those in Governmental and Municipal Bonds and securities. From a recent study of British foreign investments,[1] Sir Robert Kindersley has come to the conclusion with regard to the total British investments in foreign countries "that Government, Municipal and Railway investments account for roughly one-half of our capital and yield about one-third of our income." It is, therefore, from the Indian point of view, a redeeming feature of the British capital employed in India, that private investments form a small percentage of the total. Both official and non-official obligations, however, contribute to the total indebtedness of the country to foreigners.

Meaning of the Indian Public Debt.—The National Debt or Public Debt of a country is an entirely different matter. It takes no account of the private investments in the country. The Public Debt means the total amount of debt owed by the Public Authorities of a country, such as the Central or the Provincial Governments or Local Bodies to their own

[1] "A New Study of British Foreign Investments," *Economic Journal*, March 1929, p. 19.

citizens, or to foreigners in their individual or corporate capacities. Thus the public debt of India includes the sum total of obligations to investors in India or in England of the Central Government, the Provincial Governments, the Native States, and the local authorities such as the Presidency corporations, port trusts, improvement trusts and others.

Amount of the Total Indian Public Debt.—In arriving at a net figure for the Indian Public Debt on a particular date, certain considerations have to be borne in mind. In the first place, the Native States in India, except in a few exceptional cases, are not known to have developed the use of public credit to any considerable extent.[1] They still for the most part rely on the old method of using the hoarded wealth in their treasuries for any occasionally heavy expenditure on works of a permanent character. In any case, the figures of their public debts are not available except so far as advances have been granted to them from time to time by the Government of India. Secondly, although the provinces and the larger local bodies enjoy powers

[1] Mysore has recently (Aug. 1930) floated two loans of three crores of rupees.

of independent borrowing in the market, to a considerable degree borrowing in India is co-ordinated by the Central authority. The Government of India still largely finances the provinces and to a certain extent the Native States, and, occasionally, the larger local bodies. Similarly the provinces, in their turn, make advances to their local bodies, municipalities, district boards, and others. There is thus a certain amount of overlapping in the debt figures. Our discussion in the following pages is confined to the debts incurred by the Central and the Provincial Governments in India, although incidentally we have attempted to give a rough estimate of the debts of the larger local bodies who enjoy independent powers of borrowing in the market. The debts of smaller bodies are included in the Indian and the provincial debt figures.

According to the statement given in the Report of the Controller of Currency for 1929-30,[1] the total interest-bearing obligations of the Government of India outstanding at the close of that financial year, amounted to 11,38·23 crores of rupees. This figure includes an amonut of 142·45 crores advanced to provinces, and another of 17·57 crores

[1] Statement XXIII, pp. 74-75.

advanced to Indian States and others. On the same date the Provincial Governments had an additional liability of 16'35 crores due to direct loans raised from the money market. On the same date, again, the debts of the larger local bodies hereinafter mentioned roughly amounted to 107'08 crores,[1] out of which 21'55 crores was borrowed from the Government and another 17'49 crores was held on behalf of sinking funds or as unspent balance of the loans raised, thus leaving a net debt to the public of 68'04 crores of rupees. The total Public Debt of India therefore stood as follows:—

31st March 1930

		Rs. (Crores)
(i)	Debt of the Government of India, including advances to provinces and other loans	11,38'23
(ii)	Direct loans raised by the Provinces	16'35
(iii)	Net debt of larger local bodies after deduction of advances from the Government, sinking fund investments, and unspent balances of loans[2]	68'04
	Total Public Debt of India ...	12,22'62

[1] This is the figure for 31st March 1929, and does not include debts of all the larger local bodies.

[2] See table on page 11 for details.

DEBTS OF LARGER INDIAN LOCAL BODIES[1] AS ON MARCH 31ST, 1929

Names of local bodies	Total debt	Sterling debt	Advances from Govt.	Amount held as sinking fund
	Rs. crores	£	Rs. crores	Rs. crores
Bombay Improvement Trust	15·93	899,600	...	...
Bombay Port Trust ...	22·31	2,600,000	7·51	4·18
Bombay Corporation ...	18·74	...	9·76	2·97
Calcutta Corporation ...	6·96	500,000	...	1·28
Calcutta Improvement Trust	2·73	1,050,000	...	·48[2]
Calcutta Port Trust ...	25·32	5,950,000	2·25	3·88
Rangoon Corporation	2·72	300,000	...	1·12
Rangoon Port Commission	5·20	500,000	·40	1·76
Madras Port Trust ...	1·75	330,000	1·31	...
Madras Corporation ...	1·37	...	·22[3]	·33
Karachi Port Trust ...	4·05	1,000,000	...	1·49
	107·08	13,129,600	21·55	17·49

[1] Figures taken from the Stock Exchange Year Book for 1930. For the Bombay and Madras Corporations the figures are taken from the Annual Administration Reports of those corporations for 1927-28, and represent the debts as they stood at the end of 1927-28. Sterling figures have been converted at the rate of 1s. 6d. to the rupee. Total debt in the rupee figures includes the sterling portion.

[2] Unspent balance of loans.

[3] Only an approximate estimate of advances taken from the Government is given.

General Features of the Growth of Debt.—Let us now review the position as regards the growth of the Indian Public Debt a little more in detail. We give on the next page a table of the interest-bearing obligations of the Government of India for a number of years classified under certain heads:

There are certain features of the Indian Public Debt that are easily remarked from a first glance at the table. In the first place, the total debt has risen from 510 crores of rupees in 1914 to 11,38 crores in 1930, or more than doubled in a period of 16 years. Both sections of the debt, rupee as well as sterling, have shown an increase, but the increase has been larger in the case of Indian resources than that of foreign borrowings. The rupee debt rose from 179 crores in 1914 to 650 crores in 1930, thus increasing the proportion which the rupee debt bore to the total, from 35 per cent in 1914 to 57 per cent in 1930. The Indian money market thus contributed on an average over 29 crores of rupees per annum from all its resources during this period.

There are two important developments which may be noticed in connection with the increase in the amount of the rupee debt: (i) it is the short-term loan paper of the Government that has been more popular with the investing public in India than the long-term securities; (ii) other resources than regular rupee loans have assumed a very great importance in the war and post-war period in the financing of the capital programme of the Government of India.

Short-term Loans More Successful.—The subjoined statement showing the direct loans of the Government of India divided on the basis of short-term bonds and long-term loans, shows in what direction the money market in India has shown a tendency to develop:

SHORT-TERM AND LONG-TERM LOANS IN THE INDIAN MARKET, 1917—29

(*In crores of rupees*)

Year	Short-term		Long-term		Remarks
	Description of bonds	Amount	Amount of loan	Year of re-payment	
1917	3-year	19·8	12·5	1929-47	
	5-year	12			
1918	3, 5, 7 and 10-year.	57	No long-term.	...	10-year bonds 40% of the total.
1919	No short-term.	...	21·25	1945-55	Tax-free; issued at 95.
1920	10-year	29	·4	"	
1921	5-year	37	No long-term.		
	10-year	11			
1922	5-year	27	...	...	
	10-year	19			
1923	10-year	14	9	1945-55	Tax-free; issued at 95.
1924	9-year	7	5·9	"	Do.
1925	10-year	5	26	"	Tax-free; issued at 96.
1926	No short-term.	...	29	1960-70	All this was a conversion loan issued at 88 with heavy premiums on old converted debt.
1927	7-10 years	19	No long-term.		
1928	6-9 years	25·97	9·06	1955-60	
1929	6-year	8·05	28·81	1939-44	Long-term as good as a short-term, with a Depreciation Fund in addition.

(Compiled from the "East India Accounts and Estimates," annual "Explanatory Memoranda" of the Secretaries or Under-Secretaries of State for India.)

We notice that in by far the majority of cases, short-term bonds yielded much larger amounts of money than long-term loans. In a number of years there were no long-term loans at all. "I may, however, provisionally indicate," said Sir William Meyer when referring to the relative chances of yields to be obtained from short and long-term loans,[1] "that, having regard to the relative amounts obtained this year on the long-term loan and from the short-term war bonds, we are at present disinclined to issue a further long-term loan in 1918. I think, after consulting those who are entitled to speak with most weight on this matter, that we shall be more likely to obtain an adequate response by concentrating ourselves on short-term bonds. We might, for example, put out once more the 3-year and 5-year bonds, which were so successful this year, and add a further category of bonds having a somewhat longer period."

The system of issuing short-term bonds introduced by Sir William to get more money under the stress of war conditions has now come to stay as a permanent feature of the Indian Government's annual rupee borrowing operations. In the table given above, in the few cases where

[1] Budget Statement, 1918, para 75.

the long-term loans yielded substantial amounts in the post-war period, special causes such as the tax-free nature of the loans, special conversion facilities, the absence of fresh demand for money from the market, or the promise of repayment within a comparatively short period, explain the success of those borrowings. This circumstance of the rise of the public debt, under which long-term financing takes place by short-term funds, raises a distinct problem for solution, akin to that faced by a joint-stock banker who finances long-term industrial operations out of his time and demand deposits.

Importance of Non-Loan Resources.—Another remarkable development as regards the rupee debt is the increase of the debt in other forms than "funded loans" of the Government of India. Thus out of the total increase of 471 crores in the rupee debt, Treasury Bills and "Unfunded Debt" of the Government of India in the form of "other obligations" are responsible for yielding no less than over 211 crores of rupees, or 44 per cent of the total increase over the 1914 figure, an amount larger than that at which the whole rupee debt of the Government of India stood in 1914. In fact, "other obligations" of the Government of India formed 19 per cent of the

total rupee debt in 1914, but together with Treasury Bills, the introduction of which is a war-time development, they rose to become over 37 per cent of the total rupee debt in 1930. This figure is a measure of the importance which other resources than regular rupee loans of the Government of India have assumed in the financing of the latter's capital programme, as a result of the war and post-war financial conditions.

Growth of the Sterling Debt.—The growth of the sterling debt is no less remarkable during the period under consideration. This has increased from £247 million (330 crores of rupees at 1s. 6d.) in 1914 to £365 million (486 crores of rupees at 1s. 6d.) in 1930. We discuss the various aspects of this section of the Indian Public Debt in the next chapter. Here we stay only in order to remark a windfall in the finances of the Government of India in the post-war period which resulted from a rise in the sterling value of the rupee and the consequent reduction in the amount of the sterling debt calculated in rupees. Before the war, the value of the rupee was stabilised at 1s. 4d. Since 1927 officially, and since 1925 in all government and commercial transactions, the rupee exchange has stood at the rate of 1s. 6d. The

accounts of the Government of India were definitely begun to be kept on a rupee basis in 1921. Its revenues are also collected in rupees. The result of a rise in rupee exchange has been a lightening not only in the burden of the interest charges that are annually paid out, but also a reduction in the principal of the sterling debt. For the pre-war sterling obligations alone, this reduction in the debt on account of the higher exchange amounts to no less than 41 crores of rupees. We should not be understood to imply that the burden of debt in the shape of goods and services, in which form ultimately all external obligations are liquidated has fallen, but what is maintained is that in terms of rupees the finances of the Government of India have gained to the extent of the above amount.

Debt Largely Due to Growth of Productive Capital Expenditure.—Turning our attention now to the purposes for which borrowed funds have been used during this period, if one important thing is writ large on the face of the Indian Public Debt it is the inherently strong and solvent position of the assets by which almost the whole of the debt is covered. Thus, out of a total debt of 11,38 crores of rupees, as much as 915 crores or 80 per cent is invested either in revenue-earning

assets such as railways, posts and telegraphs, and other commercial departments, or spent in recoverable loans and advances to provinces, Indian States and other bodies. In the seven years from 1923 to 1930 the capital advanced to railways amounted to a sum of no less than 214 crores of rupees (or on an average, 30 crores per annum). This was a period during which the Government undertook heavy capital expenditure on the construction of new railways, bought out some railway lines, and took over the direct management of a few others, assuming direct financial responsibility for the debt liabilities of those railways to the extent to which the incoming properties were encumbered. The advances to provinces increased from 71 crores in 1921 to about 142 crores in 1930. It is true that owing to India's war contribution to Britain of a hundred million pounds, to post-war budget deficits of 98 crores of rupees, and the construction of New Delhi at a cost of over 13 crores of rupees, the unproductive debt in the post-war period has risen to a high figure. But when we analyse the position a little more closely, we find that even against the remaining 223 crores of "uncovered" debt which is not invested in the above manner, there are tangible assets amounting

to 46·78 crores in the form of "cash, bullion and securities held on Treasury Account," another 41·94 crores held on account of Railway Depreciation and Reserve Funds and Provincial Balances (which are entirely Government moneys and must be set off against Government debt liabilities), and the Gold Standard Reserve of £40 million (53·33 crores of rupees) held in London on behalf of the Government of India. These three assets bring down the uncovered or unproductive debt to the small figure of 81 crores, or 7 per cent of the total debt. No important country in the world can boast of a stronger financial position as regards its public debt and the corresponding assets.

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CHAPTER II

STERLING DEBT

LET us now take into consideration the sterling borrowings of the Government of India. The measure of the sterling debt can be given by three figures. In 1900 it stood at £119·64 million, in 1914 it was £177·06 million, and on the 31st March 1929, it was £352·54 million. For the period from 1914 to 1929 during which its growth was most marked, a statement showing the Indian sterling debt in each year is appended to this chapter. By far the greater portion of the addition made in the twentieth century has taken place either for the construction of new, or for the purchase or liquidation of old State railways. The policy of active railway construction and consequent heavy sterling borrowings began in 1907. In that year, on the representation of a number of London businessmen, Lord (then Mr. John) Morley, the Secretary of State for India, appointed what is known as the Mackay Committee, which recommended a capital

expenditure on the development of railways in India of £12½ million annually.[1] Before 1907-08, the Government of India had not for many years borrowed more than £3 million in England in any particular year. In that year, two loans were floated totalling a sum of £8½ million secured by offering a higher rate of interest than usual; and for the next few years, heavier liabilities were incurred in England than ever before. Then came the period of the Great War during which the London money market was almost completely closed to external borrowers. For five years, from 1916-17 to 1920-21 inclusive, India did not put in an appearance as a borrower in London at all. But, as will be found from the figures given in the Statement printed on page 31, in the next three years (1921-22 to 1923-24), heavy—very heavy—borrowings were made on behalf of India. During that period, loans were raised, by means of five issues amounting to £70 million.

After June 1923, no new sterling issue on behalf of India was launched in London until January 1928, when £7½ million was asked for, virtually after five years, although technically the

[1] Para 17, Cd. 4111 of 1908.

interval was three years, and it was followed by an issue of £10 million in January 1929, and the last one, of £6 million in February 1930.[1]

Remarkable Growth of Indebtedness in the Post-War Period.—The above, however, does not reveal the whole story of India's post-war debt in Britain. It only partially explains the increase. India's obligations in Britain have increased during the post-war period in more than one way. Thus, on the direct assumption by the State of the control and management of the East Indian and the Great Indian Peninsula Railways, in the years 1924 and 1925 respectively, the Indian Government had to take over the debenture liabilities of those companies, which amounted to £18½ million in the case of the E. I. Ry. and £3½ million in the case of the G. I. P. Ry. This total of £22 million, in the words of the Finance Member of the Government of India,[2] "while it represents an addition to the direct obligation of the Government, does not of course represent any addition to the indebtedness of India as a whole, being merely a transfer from the railway company to the Government of the liability to

[1] Another 7 million sterling loan was raised in May, 1930.

[2] Budget Speech of 1925.

meet the same interest charge out of the earnings of the same railway." The encumbrance on the property was already there. What the State did was to transfer the liability from the company directly to itself. As any half-yearly Parliamentary Return on the public debt of India would show, no fresh loan for the purpose was incurred in England.

Another more or less similar book debit which must be taken into account when considering sterling obligations, is that which has been made in respect of railway annuities. The Government has contracted to buy out certain railway lines from the companies, and the payment of their purchase price is spread in annual instalments over a long period of years. This liability has existed for a long time, but has appeared as a sterling obligation in the Finance and Revenue Accounts of the Government of India only since 1924-25. £53·35 million of the increase over the 1914 figure is accounted for under this head.

Lastly, India had decided upon a war gift to Britain of £100 million. The greater part of it was paid off with the proceeds of several War Loans. It was arranged for the rest to be paid in instalments. The Indian Government has acknowledged

it as a part of the 5 per cent British Government 1929—47 War Loan, and the liability of the Indian Government remaining in that connection stood at £16·72 million on the 31st March 1929. This is the only liability that the Government of India owes direct to the British Government. The whole of the remaining sterling debt of India is owed to the investing public of Great Britain, and not to their Government.

Summarising the increase of £175·48 million in 1929 over the 1914 figure, we find it accounted for as follows :—

	£ m.
E. I. R. & G. I. P. R. Debentures ...	22·00
Railway Annuities shown in Accounts since 1924-25	53·35
Liability for British Government 5% War Loan (1929—47) taken over by India	16·72
Remaining loans	83·41
Total ...	175·48

Money Market Tendencies in the Pre-War Period.—We shall examine next the money market conditions under which this increase in the sterling portion of the Indian Public Debt in the twentieth century has taken place. We refer

the reader to the Statement printed on page 31 wherein the comparative terms of issue of sterling and rupee loans are given for a number of years. It will be observed that the century opens with a lower rate of interest and a higher price of issue for Indian loans in London than those in India, the sterling rate of interest being 3 per cent as compared with the Indian $3\frac{1}{2}$ per cent. The issue price of sterling loans continues to weaken in subsequent years till in 1907-08 the sterling rate of interest has to be raised to $3\frac{1}{2}$ per cent and becomes identical with the Indian rate. The comparison between the terms of issue of sterling and rupee loans now becomes easier. We find that even the price of the new $3\frac{1}{2}$ per cent sterling stock continues to fall, till, in the year 1910-11, a rupee loan is actually issued at a slightly better rate than the corresponding sterling loan of that year (the price of issue of the rupee loan being Rs. 96-1-3 while that of the sterling, 96). There is no sterling loan in the financial year 1911-12, but in the following year the issue price of the $3\frac{1}{2}$ per cent sterling stock further drops by three points, while the issue price of the rupee paper slightly improves on the 1910-11 figure. In the following few years, a few loans are raised in London in the form of Railway Debenture Stock on which we find that usually a

higher rate than $3\frac{1}{2}$ per cent is paid, while the corresponding Indian rate remains steady at $3\frac{1}{2}$ per cent. In 1915-16, while the Indian terminable rupee loan is raised at par at four per cent, the East Indian Railway Debentures are issued in London at 99, at four and a half per cent.

STATEMENT SHOWING THE TERMS ON WHICH RUPEE AND STERLING LOANS HAVE BEEN RAISED IN THE TWENTIETH CENTURY

(The figures have been compiled from the annual "Explanatory Memoranda" of Secretaries or Under-Secretaries of State for India. The schedule excludes a few small sterling railway issues of pre-war times, and all the post-war rupee loans in years in which there were no sterling loans. The table shows how London has shown a tendency to become more expensive than India during the last 20 years.)

YEAR	RUPEE LOANS			STERLING LOANS			
	Int. rate	Issue price	Amount raised	Int. rate	Issue price	Amount raised	Remarks
	%		Rs. Crores	%		£ m.	
1901-02	3½	97·3	1	3	98	3	
1902-03	3½	97·6	1½	3	101-10-2	1½	
1903-04	3½	98·1	2	3	98-19	1½	
1904-05	3½	97·6	3	3	95-18-6	2½	
1905-06	3½	98·8	4	3	97-18-1	2	
1906-07	3½	97·3	4½	3	94-16-5	2	
1907-08	3½	96·87	2½	3½	9 -10	3½	Rise to 3½%.
				3½	99	5	
1908-09	3½	95·44	2	3½	97	7½	
1909-10	3½	93·94	2½	3½	96-10	7½	
1910-11	3½	96-1-3	1½	3½	99-11-7¼	4	Repaid in 8 instalmts.
				3½	96	3½	Indian rate cheaper.
1911-12	3½	96-3-10½	2	...	...	...	No £ loan.
1912-13	3½	96-2	3	3½	93	3	
1913-14	3½	96-8-8	3	4	99	2½	Ry. Debs.
1914-15	3½	95-9-7	5	4	97-10	2	
1915-16	4	100	4½	4½	99	3½	Ry. Debs.
1921-22	6	100	49	7	100	7½	Repayable 1926-31.
				5½	93-10	10	„ 1932
1922-23	6	100	47	5½	96	12½	„ „
				4½	85	20	„ 1950-55
1923-24	5	97	14	4½	90	20	„ „
	5	96	10				
1927-28	4	94-8	19½	4½	91-10	7½	„ 1958-68
1928-29	4½	94	9	4½	91	10	„ „
	4½	97-8	26	...	...	...	23% £ loan undigested.
1929-30	5	96-8	28·81	6	99	6	6 times oversubscribed.
	5	98	8·95				

The most natural question that arises in one's mind on this phenomenon is: why did borrowing in the United Kingdom become more expensive in the decade before the war? The most prominent feature of British finance in this period was its tendency to become more and more international in character. There was a craze for foreign investments in the United Kingdom as well as on the Continent. So far as the United Kingdom is concerned, this statement is borne out by the following figures:—

CAPITAL ISSUES IN THE U. K., 1900—1913
(*In millions of pounds*)

YEAR	Total capital issues in U. K.	Foreign & Colonial issues in U. K.	% of second to first
1900	165	67	40
1901	159	66	41
1902	154	64	41
1903	108	61	56
1904	123	80	65
1905	166	120	72
1906	116	78	67
1907	121	82	67
1908	192	141	73
1909	182	167	91
1910	267	207	77
1911	192	166	86
1912	211	165	78
1913	196	160	81

(Taken from the figures given in the appendices of "Imperial Finance" by Messrs. Cooke and Davenport, based on the *Economist.*)

The above table clearly shows that as time went on, the proportion which capital raised for investment abroad bore to the total amount of capital raised in the United Kingdom for all purposes, domestic or foreign, gradually increased from 40 per cent at the beginning of this century, to over four-fifths of the total issues in the year just preceding the war. In one year we find that over nine-tenths of the capital raised was exported abroad.

The natural result of such a state of affairs was a rise in the money rate. India was not alone in raising her interest rate for borrowing in London from 3 to 3½ per cent. Canada, the various States of Australia, and South Africa, who had been borrowing in London at 3 per cent for a number of years, had also to put up their rates of interest one after another in order successfully to float their capital issues in London in the face of increasing competition. The influence was felt no less on domestic requirements than on foreign issues. Lord Faber, an eminent banker and himself a member of the 1913 Indian Currency Commission, stated in the course of the examination of a witness before that body, that English capital had become bolder and bolder in the preceding eight or

ten years and sought for a larger rate of interest. A few years earlier, in a controversy that was going on in Britain, in the Press as well as on the platform regarding the "export of capital," Lord Faber had expressed the opinion that certain home requirements, particularly railways, experienced some difficulty in raising the necessary amount of capital. They had to offer more generous terms than those at which money could be obtained previously.[1]

Easier Monetary Conditions in India.—This was undoubtedly true so far as conditions in the London money market were concerned. But there is internal evidence to show that monetary conditions were easier in India than in London. A number of witnesses who appeared before the Chamberlain Commission held this view and consequently favoured the issue of larger amounts of rupee loans in India. "It is a matter of notoriety," said Mr. Abraham of the India Office,[2] "that year by year it has in recent times been becoming more difficult to issue loans on favourable terms in England"; and again, Mr. Newmarch, Financial Secretary to the Government of

[1] *Economist*, January 15th, 1910, p. 127.
[2] Cd. 7069, 1913, p. 2, Q. 15.

India, stated before the same body: "It may be remarked incidentally that whereas until recently the sterling loans of the Secretary of State could be issued in London more cheaply than the rupee loans of the Government of India in that country, of late years the tendency has been in the opposite direction. Thus, in 1912, the 3½ per cent loan of the Government of India for three crores of rupees was issued at an average price of 96⅛, whereas the Indian sterling loan for £3 million, underwritten, was issued at 93." The Commission itself wrote "that at the moment the Government pay less for their borrowings in India than for what they raise in London, and that besides taking up the new issues of rupee paper, India has in the last ten years been buying some of the holdings of this (Rupee-enfaced paper) security in the United Kingdom."[1]

London-enfaced Rupee Paper.—This brings us to consider the position of the London-enfaced rupee paper. This (i.e., the rupee loans of the Government of India standing on their London register for the payment of interest there) stood at about 24 crores in 1897-98 and came down to about nine crores of rupees in 1915-16. The

[1] The Chamberlain Currency Commission Report, para 167.

whole of this amount of 15 crores or so was repatriated from London by purchase, and slowly absorbed by the Indian money market, when its natural thirst for Government paper was not locally quenched. This occurred in spite of the fact that the price of the London-enfaced $3\frac{1}{2}$ per cent paper remained very steady at about 64 throughout the pre-war period. The following table showing the gradual reduction of the London-enfaced rupee paper, year by year, speaks for itself.

TABLE SHOWING THE MAXIMUM AND MINIMUM AMOUNTS OF RUPEE PAPER STANDING ON THE LONDON REGISTER OF THE GOVERNMENT OF INDIA FOR PAYMENT OF INTEREST DRAFTS, TOGETHER WITH MAXIMUM AND MINIMUM PRICES THEREFOR SINCE 1897

(In crores of rupees)

YEAR	Maximum amount outstanding	Minimum amount outstanding	Maximum price	Minimum price
1897-98	23·47	21·39	$64\frac{1}{2}$	$60\frac{7}{16}$
1898-99	21·93	21·33	$67\frac{7}{16}$	$61\frac{1}{2}$
1899-1900	21·36	20·28	$67\frac{5}{8}$	62
1900-01	22·25	20·84	65	$62\frac{5}{16}$
1901-02	22·34	20·23	$64\frac{3}{4}$	63
1902-03	20·28	18·63	$66\frac{1}{8}$	$64\frac{1}{2}$
1903-04	18·61	17·05	$66\frac{3}{16}$	64
1904-05	17·02	16·50	$66\frac{5}{8}$	65
1905-06	17·01	16·21	$66\frac{9}{16}$	$65\frac{5}{8}$
1906-07	16·92	16·30	$66\frac{3}{8}$	$64\frac{3}{16}$
1907-08	16·44	15·23	$65\frac{3}{4}$	$62\frac{3}{4}$
1908-09	15·29	14·43	$63\frac{13}{16}$	$61\frac{5}{8}$
1909-10	16·06	14·81	$63\frac{5}{16}$	$61\frac{7}{8}$
1910-11	15·07	12·78	$64\frac{9}{16}$	$62\frac{11}{16}$
1911-12	12·68	11·73	$64\frac{5}{8}$	$63\frac{1}{2}$
1912-13	11·65	11·13	$64\frac{3}{4}$	$63\frac{5}{16}$
1913-14	11·11	10·08	$64\frac{5}{8}$	63
1914-15	9·95	9·73	$63\frac{7}{8}$	$63\frac{1}{2}$
1915-16	9·66	8·81	...	...

(Compiled from the appendices of Financial Statements.)

It will be noticed that the greatest single drop in the amount of rupee-enfaced paper outstanding on the London register took place in 1910-11, the precise year when the open market rate of interest on Indian rupee loans in India became cheaper than the rate of sterling loans in London.

Further evidence of the same phenomenon may be observed from a comparison of the maximum and minimum prices of 3½ per cent rupee paper at Calcutta, and 3½ per cent sterling stock in England, made in the table which follows :—

Comparative Maximum and Minimum Prices of $3\frac{1}{2}\%$ Rupee Paper at Calcutta and $3\frac{1}{2}\%$ Sterling Stock in London for Different Years

Year	$3\frac{1}{2}\%$ Rupee Paper at Calcutta		$3\frac{1}{2}\%$ Sterling Paper in London	
	Maximum price	Minimum price	Maximum price	Minimum price
1900-01	97-12	93-11	$111\frac{1}{2}$	105
1901-02	97-7	94-7	$109\frac{5}{8}$	$106\frac{1}{4}$
1902-03	99-9	96-12	$110\frac{5}{8}$	$105\frac{1}{4}$
1903-04	99-7	94-10	$108\frac{7}{8}$	102
1904-05	99-9	96-11	109	103
1905-06	100-4	97-8	$107\frac{5}{8}$	$103\frac{1}{8}$
1906-07	99-11	94-13	106	$99\frac{1}{2}$
1907-08	98-6	95-8	103	$96\frac{3}{4}$
1908-09	96-15	93-2	$102\frac{1}{8}$	$95\frac{7}{8}$
1909-10	95-5	92-12	$100\frac{3}{8}$	95
1910-11	96-10	93-6	$97\frac{5}{8}$	$92\frac{3}{8}$
1911-12	96-14	94-12	$96\frac{3}{4}$	91
1912-13	97-2	94-12	$94\frac{11}{16}$	89
1913-14	96-12	94-14	$93\frac{1}{2}$	$84\frac{5}{16}$
1914-15	96-1	91-8	$90\frac{1}{2}$	$80\frac{3}{4}$

(Compiled from the appendices of Financial Statements)

This table shows that the maximum price of 3½ per cent rupee paper at Calcutta remained more or less steady at round about 96 during the whole of the period under consideration, while the maximum price of 3½ per cent sterling paper dropped from 111½ in 1900-01, to 90½ in 1914-15, a difference of 21 points. The difference is even greater in the case of the minimum prices of sterling paper between the same dates, the drop being nearly 25 points. All this establishes beyond a shadow of doubt that London had begun to reveal very distinct tendencies towards becoming dearer than India's own money market, several years before the war.

POST-WAR MONETARY CONDITIONS IN LONDON

Turning now to the post-war period, all the eight loans of these years except that of 1922-23 (a sterling issue of £20 million at 85 and 4½ per cent rate of interest) have been offered in London at more attractive terms than those granted to investors in rupee loans in India in corresponding years. The following small table summarises the post-war position:

COMPARISON OF RUPEE LOANS WITH STERLING LOANS RAISED IN THE POST-WAR PERIOD

(Sterling loans are given in millions of pounds—Rupee loans in crores of rupees)

YEAR	STERLING LOANS				RUPEE LOANS			
	Amt.	Int.	Issue price	Maturity date	Amt.	Int.	Price	Redemption date
1921-22	7½	7%	par	1926-31	49	6%	par	1926-31
	10	5½%	93½	1932				
1922-23	12½	5½%	96	1932	46	6%	par	1927-32
	20	4½%	85	1950-55				
1923-24	20	4½%	90	1950-55	(i) 14	5%	97	1933 2 sections
					(ii) 19·7	5%	96	1945-55
1927-28	7½	4½%	91½	1958-68	19½	4%	94½	1934-37
1928-29	10	4½%	91	1958-68	(i) 26	4½%	97½	1934
					(ii) 9	4½%	94	1955-60
1929-30	6	6%	99	1932-33	(i) 28·81	5%	96½	1939-44
					(ii) 8·05	5%	98	1935

The conclusion is irresistible that the Indian rate has definitely shown a tendency to be cheaper than the sterling rate since 1910; or, to put it more accurately, London has become more

expensive while India has shown considerable signs of expansion and mobilisation of her capital resources. The excess of the open London rate over the Indian rate has been at times very appreciable, particularly during the last three years. Moreover, the real difference in the rates of interest at the two places would work out to be much greater than these figures show if we take into consideration the fact that the income derived from the interest on the Indian rupee loan paper is a taxable asset in India, whereas the interest paid on the sterling debt held in England is exempt from Indian income-tax.

Thus we find that money can now be raised in India on much cheaper terms than in London. The unattractive terms at which the recent rupee loans have been issued have militated against the success of those loans, and have resulted in the diversion of funds from India to seek more profitable investments abroad. Under the heading "Indian Investments in Foreign Countries," a correspondent wrote as follows in the London *Economist*, dated October 6th, 1928: "During the war owing to the appreciation of rupee exchanges, much Indian capital first commenced to flow in Europe and America for purposes of speculation and subsequent investment. Before

this, both Indians and Europeans normally invested their surpluses in Indian industrial and governmental issues. At present, however, not only the Europeans, but the wealthier Indians have extensive interests in foreign securities. Numerous reasons are adduced for the export of funds, but the following five factors are probably the chief: (1) After the cessation of hostilities, the Indian investments held abroad continued to grow owing to the appreciation of the rupee currency; (2) landed property in India has been in the throes of rapid depreciation or rather rapid recovery to normal values during the last five years; (3) the lack of non-speculative industrial issues and the fact that such centres as London, New York and Paris offer attractive propositions to investors; (4) the circumstances that Government Promissory Notes, Municipal Bonds and India paper are low-yielding when compared to securities of like character in Europe and America; (5) the caution of bankers themselves with regard to advances in India. As the general level of interest rates has been steadily declining owing to gradual elimination of money-lending, the inundation of British investments increases, but owing to the assiduous publicity given to "dollar" securities in India, a perceptible trend

towards American issues is now prevalent. Moreover, the yield of many dollar, industrial or public utility bonds is maintained above 5 per cent with the added advantage of the interest being exempted from taxation in the U.S.A. as well as from the tax of the country of origin. Bombay has proved a keener investor than Calcutta in foreign bonds, owing doubtless to increased savings arising from larger earnings of the average businessman, and the generally better yield for money on the Western coast. The Government of India had recently failed to attract Indian capital owing to the unattractive terms of their loans, but the welcome accorded to this year's issue,[1] indicated that we may look forward to a change. The volume of business transacted through the Indian banks remains unknown owing to the secrecy generally prevalent in the spheres of investments, but enquiries in London and India suggest a tentative estimate of about 50 crores of rupees (about £37 million). This figure is quoted with some hesitancy as the vast investments of the ruling princes—who have personal connexions in the world's money markets—are

[1] In the case of the 1927 loan, the rate was 4% at the time of issue, but was increased to 4½% in the following year. The 1929 rupee loan was offered at 5%, and the 1930 at 6%.

not altogether included. The proportion of India's share in the London capital market has been well maintained during the current year, and is computed to be over £10 million." These paragraphs indicate very clearly the kind of forces which underlie the phenomenon pointed out in this chapter—that the Indian money rate is now easier than rates at those places where money used to be cheaper in former years.

CAUSES OF HIGH MONEY RATES IN LONDON

Shortage of Savings.—Why has London borrowing become so highly expensive in the post-war period ? To begin with, far different circumstances from those that ruled in pre-war years have governed post-war money market conditions in London. The stringency of latter years is explained by a number of extraordinary factors arising out of the war. Some of those factors are of national, and others of an international character. A few, very few indeed, may be peculiar to India alone. In general, however, the demand for money is very keen and its price has gone up owing to a number of reasons. One major difficulty resides in the fact that, owing to

the depressed condition of staple industries in Great Britain in the post-war period, savings have not been commensurate with the requirements for capital, especially if due account is taken of the higher level of prices and the larger population. Thus, in the view of the Committee on National Debt and Taxation,[1] "while nominal savings have increased, real savings exhibit a decline which may amount in present money values to something like £150 to £200 million" in comparison with the pre-war period.

Playing for Safety.—In the second place, the War resulted in the destruction of large amounts of accumulated capital equipment, and put a heavy strain on the rest that remained working; and capital renewal and rehabilitation is one of the most important financial problems of the post-war world. There has been a very great increase in the need for capital for the rationalisation of industry at home. Even the co-operation of American capital in British industry is invited and welcomed. Home issues, government and municipal as well as industrial, have shown a remarkable capacity for the absorption of capital even at the post-war prevailing

[1] Report, p. 17.

high money rates. Whereas in the pre-war decade (1904-13), out of the total capital issues of £1,768 million raised for all purposes in the United Kingdom, home issues absorbed £398 million or only 22 per cent of the total, in the post-war decade (1919-28), out of total issues of £4,034 million raised for all purposes, the United Kingdom's own home requirements have been responsible for no less than £3,009 million, or 74·5 per cent of the total issues.[1] Home government and corporation stocks provide the best trustee securities, and they have, generally speaking, promised handsome yields during this period. But even the industrial issues have provided the necessary safety in the post-war conditions by adapting themselves to the changed circumstances. The point is well illustrated by the following figures from the Colwyn Committee Report[2]:

YEAR	Ordinary issues	Preference	Debentures	Total	Ratio of (3) to (4)
	(1)	(2)	(3)	(4)	
1913	£20 m.	£20 m.	£13 m.	£53 m.	25 %
1921	18 m.	14 m.	57 m.	89 m.	64 %
1922	12 m.	13 m.	50 m.	75 m.	66 %
1923	14 m.	15 m.	38 m.	67 m.	57 %

[1] Appendix, "Imperial Finance."

[2] P. 20.

The above figures show which way the wind is blowing, how the home investor has shown an anxiety to play for safety, and how that safety has been insured in an increasing degree in the case of home industrial issues by the flotation of larger quantities of preference and debenture stock. From 25 per cent in the pre-war year, the percentage of secured industrial capital in the form of debentures has risen to between half and two-thirds of all the home industrial issues in some years since the war. When it is remembered that (excepting only home railways) home industrial stock, whether ordinary, preference, or debenture, does not enjoy the status of trustee security, and has consequently to be offered on decidedly more attractive terms than other stocks enjoying that status, it can easily be realised that, forming as it does a large part of the internal demand in the London money market, it tends to raise the rate of interest for all kinds of borrowings.

World-wide Stringency of Credit.—It is stated on high authority that the balance of international accounts does not encourage foreign lending. "There is more than a suspicion," wrote the Chancellor of the Exchequer

to *The Times*, towards the end of July 1929, "that we have during recent years been lending or investing abroad more than our international balance of accounts justifies, and what I particularly had in mind was that a certain caution in this respect must be observed." Although foreign non-Empire borrowing has declined from £809 million in the decade before the war, to £354 million in the post-war decade,[1] the readiness of the various European States and other oversea borrowers to take advantage of easy money conditions in London any time that the market shows signs of improvement, for borrowing for short or long periods, tends to keep the rate of interest in London high. It is a well-known fact that capital has become very much more mobile now than before the war. Any strong tendency for financial operations of some particular kind at any time in one of the world's big money markets is certain to have its repercussions on all other financial centres. The great American boom of recent years of course provides the best illustration of the point. The great Wall Street gamble in industrial securities has affected the world adversely in recent years in a number of ways. "It did," wrote *The Times*

[1] *Vide* "Imperial Finance."

on October 28th, 1929, " much damage, for the speculative mania diverted capital from urgent and serious purposes. For the past two years America has ceased to lend money to countries which badly needed it, and has thereby added to the burdens of London. Worse still, she not merely ceased to lend, but borrowed extensively. New York became the Mecca of the speculator, foreign capitalists being induced either to join in the speculative boom themselves, or to lend their money to American speculators who offered high rates. American speculation is largely, if not entirely, responsible for 6½ per cent Bank Rate in this country, and for the general monetary stringency throughout the world."

The difficulties of London, which has recently been driven to bear the brunt of the world's demand for money, can be very well understood if we take into consideration the further fact that the central gold reserve of the Bank of England, on which, after all, the whole superstructure of credit and the capacity of the country for foreign lending so much depend, is much smaller than the gold holdings of either France or America.

Presence of Large Unfunded Debt.—Another very important cause of dear money in

London is the presence of the large quantity of unfunded debt of the British Government, which, in addition, bears a high rate of interest. The embarrassing character of the short-term indebtedness may be gathered from the fact that early maturities in 1932 amount to £121 million, in 1933 to £65 million, in 1934 to £227 million, and in 1935 to £115 million. The problem of funding the above early maturities is further complicated by the urgent necessity of converting the huge 5 per cent 1929-47 British Government War Loan. All the implications and bearings of this problem cannot be more fitly described than in the words of Sir Basil Blackett who wrote recently as follows[1]: "The existence of this huge loan of over £2,000 million issued on the security of the consolidated fund of Great Britain, carrying 5 per cent interest and yielding practically 5 per cent at present market prices, ripe for repayment and unrepaid, is responsible for adding at least ½ per cent to the cost of all new borrowing in the London market, whether the borrowers be governments, public bodies or industrial or commercial concerns."

[1] Special Annual Banking Supplement of the *Financial News*, 1929.

The favourable time for a conversion is when the supply of capital for investment is relatively large and the demand relatively small. Even a small extra demand hardens up rates, and so in a period of conversion operations, the market does not want extensive competition from new borrowers of fresh money, and frowns on expansive loan programmes. The inexorable laws of short supply and keen demand have been very well reflected in a recent conversion operation of the British Government (November 1929) when the latter was forced to convert a part of the big 5 per cent loan at the same rate for a further period of 14 years, an operation which provoked the following comments from the London *Times*:

> "Even if Mr. Snowden had chosen a loan of the 4 or $4\frac{1}{2}$ per cent type, it would have had to have been offered on terms giving a yield something approximating very closely to 5 per cent. Not for eight years have financial circumstances been so unfavourable for capital issues. There is a world-wide stringency of credit, the result partly of the wild speculative movements which have swept over the stock exchanges here and abroad, and particularly in New York, and have caused a diversion of funds from productive to less essential

purposes. In this country, the relative scarcity of capital is also largely the outcome of the great depression which has prevailed for so long in the staple industries of the country, and of excessive spending both by Parliament and by private individuals, the result of which has been diminished savings, high taxation and raids upon the sinking funds for the redemption of debt. Parliament bears a heavy responsibility for the fact that eleven years after the armistice, the British Government is still compelled to borrow on a 5 per cent basis."

Effects of High Income-Tax.—While we are talking of high money rates in London, the point of view of the investor, who, after all, receives only a fraction of the increased income on his investments in the post-war period, should not be lost sight of. The war necessitated heavy increases in the rates of direct taxes on income, with the result that the net yield to the lender from his investment is much smaller than the apparent increase in the rate of interest indicates. Whereas the standard rate of income-tax was 1s. 2d. in the £ in 1913-14, after a rise to as much as 6s. in the £ in 1920-21 and 1921-22, it gradually came down

to 4s. in the £ in 1925-26.[1] Mr. Snowden has now raised it to 4s. 6d. in the £.[2] The effect of this can be made clear by an example. Suppose a person invested £100 in the pre-war period at 4 per cent rate of interest; he paid income-tax then at the rate of 1s. 2d. in the £, and was still in a position to enjoy a net income of £3-15-4 on his investment. Under the stimulus of a better rate of interest, and in order to meet higher prices and taxation, he converted his pre-war holding into one of 5 per cent. Owing to a 20 per cent standard rate of income-tax in 1925-26 he finds that his net income has increased from £3-15-4 in the pre-war period only to £4 in 1925-26, or by less than one-quarter of one per cent, although the investment is now held in 5 per cents instead of 4 per cents before the war. In earlier years the increase would have been even less. Leaving aside the questions of the comparatively greater scarcity of capital, and the higher prices ruling in the post-war period, a certain increase in the rate of interest, therefore, is due to the investor on account of his having to pay income-tax at a much higher rate than before the war, if he is to enjoy the same net

[1] Report of Colwyn Committee on National Debt and Taxation, pp. 122-3.

[2] 1930 Financial Statement.

average income as he did on his investment before the war.

So far, also, we have taken into consideration only the ordinary rates of income-tax. The imposition of progressively graduated rates of super-tax on higher incomes leaves a much smaller net yield in the hands of those that enjoy large unearned incomes from investments of this character. This aspect of sterling loans was recognised by the Minority Report of the Indian Railway Committee (1921). "We anticipate," they wrote, "that so long as income-tax in England continues to be levied at the present high scale, money will be obtainable in India on more favourable terms than in the London market, and the Indian money market should be exploited to the fullest extent..."[1]

FALL IN INDIA'S CREDIT—A MYTH

We have travelled far in order to show how the effects of the destruction of capital during the war, shortage of post-war savings, higher taxation, world stringency of credit, the presence of a large amount of unfunded debt, increased demand for capital at home for rationalisation purposes, and the readiness of external borrowers to take

[1] Cmd., 1512, 1921, para 305.

advantage of the easy money market conditions, have all combined to keep money rates high in London in the post-war period. Given a borrower of good standing, any amount of money can still be raised; but the market has to be paid; and its post-bellum price, as we have shown above, has tended to be very high. A very pertinent question in this connection, and one that has come to the fore in recent times, is the question of India's credit in the London money market. Has India's credit there really fallen? Has the credit of the country anything to do, and if so, to what extent, with the terms at which post-war Indian sterling borrowings have taken place in London ?

At the outset, far from there being doubts as to her credit, India has claims to be counted among England's best borrowing clientele, for a number of reasons:

(1) About four-fifths of her public debt represents solid assets such as railway properties, irrigation works and other equally good investments. These assets also yield more revenue than is needed to cover the interest charge for the entire debt, both productive and unproductive.

(2) The money raised in England on behalf of India is mostly spent in England on the purchase of railway materials,[1] or to repay the old investors in Indian railways. In the latter case, it does not cause any disturbance to the London money market, and in the former it tends to promote British export trade with India.

(3) India has never been a defaulter like Russia, who has repudiated all her British debts; or Turkey and China, who have so frequently not been able to meet their obligations punctually in respect of interest payment or the repayment of principal; or like Australia, whose borrowings in London in recent years amount, in effect, to the payment of her interest bill in London and cannot therefore claim very extensive promotion of Imperial trade thereby.

(4) India keeps her reserves and balances of about £50 million in London, which, in a way, amounts to a pledge for the discharge of her sterling obligations.

[1] Parliamentary Debate on East India Loans, 17th July 1923.

(5) India has always made a very liberal provision for debt redemption—a provision which is sometimes not warranted by the unproductive portion of her debt—simply in order to maintain her credit with her creditors both in India and in England.

(6) Finally, the revenues of India, and the properties of the state in which sterling moneys are invested, are still largely administered and controlled by the representatives of the British nation by men of their own race.

But has there been any weakening of India's prestige in London? There are a few features of her post-war sterling borrowing operations that are interpreted as symptoms of her declining credit in London. They are as follows: (i) that depression in the prices of Indian sterling securities has persisted in the post-war period; (ii) that India has not only been required to issue fixed-dated loans, but some of her loans have been issued for very short periods, whereas they used to be non-terminable before the war; (iii) that India draws more heavily on the London money market now than before the war; (iv) that recently (January 1929) nearly a fourth of India's

sterling loan was left undigested by the market; (v) that her post-war borrowings have been made in London on highly expensive terms. We shall now examine these features seriatim.

(i) **Depression in the Prices of Securities.**—Fluctuations in the prices of securities form rather inconclusive evidence on which to establish the high or low credit of a country at home or abroad. We have already shown that there was a strong tendency for the prices of Indian sterling securities—along with so many other gilt-edged securities—to fall in London before the war, and yet that fall could not be ascribed to any loss of Indian credit in that market. In fact, such fluctuations are due to numerous political, social, economic and psychological factors, rational and irrational, factors arising in India and in London as well as those absolutely unconnected with either. In the long run, however, the prices of securities are a true reflex to the money market conditions, and a good deal may be learnt from careful analysis.

We give below two tables, one showing the maximum and minimum prices of sterling securities in London, and the other showing the maximum and minimum prices of rupee securities at Calcutta, for a number of years.

PRICES OF STERLING SECURITIES IN LONDON [1]

YEAR.	3½% max.	3½% min.	3% max.	3% min.	2½% max.	2½% min.	5½% max.	5½% min.	4½% max.	4½ % min.	7% max.	7% min.
1913-14	93½	84 5/16	80¾	71½	64 11/16	59¾						
1914-15	90½	80¾	77¼	69¼	64	58						
1915-16	82⅝	80¾	70¾	69¼	59⅜	57						
1916-17	80⅞	62¾	69⅜	55¼	57⅛	47						
1917-18	69⅞	61¼	60¼	53	50	45⅛						
1918-19	74	62	64	53¼	53⅞	44¾						
1919-20	69⅞	54⅛	60¾	47½	50¾	40						
1920-21	*61*	*51⅛*	*53*	*43½*	43	37⅜						
1921-22	63¼	55½	55½	47¼	46⅝	39¾	94½	89¾	...	...	108¼	102½
1922-23	69⅜	62½	59½	53½	50⅛	44½	102½	93⅛	88½	83⅜	119½	108
1923-24	*72½*	*61¼*	*62⅝*	*52¾*	52½	44¾	105	99	93	82¾	124	107¾
1924-25	69⅝	63	59¼	54	49½	45	103½	100	89¾	85½	115¼	104½
1925-26	69¼	63¼	59¼	54⅜	49¾	46⅝	103	99⅜	91⅛	85⅛	106½	102⅝
1926-27	74⅛	67⅝	63¼	57¾	52¼	48 7/16	104	101	93⅛	88¼	104¾	101⅝
1927-28	*73⅜*	*68*	*63⅜*	*59*	52	49	103½	100⅝	94¾	89⅝		
1928-29	72½	67	62½	60	52½	50	103¾	100⅞	95 1/16	91½		
1929-30	70	55¾	60	47	50½	40¼	102	96	91⅝	78		

Points of improvement in 1927-28 over 1920-21 in the case of 3½% and 3% stocks:—

	3½% max.	3½% min.	3% max.	3% min.
	12	17	10	16
In 1923-24 over 1920-21	11	10	9	9
In 1927-28 over 1923-24	1	7	1	7

[1] Compiled from the appendices of Financial Statements.

PRICES OF RUPEE SECURITIES AT CALCUTTA[1]

YEAR		$3\frac{1}{2}$% max.	$3\frac{1}{2}$% min.	3% max.	3% min.	5% max. 1929-47	5% min. 1929-47	5% max. 1945-55 T.F.	5% min. 1945-55 T.F.
1913-14	...	96-12	94-14	83	82	...	...	...	...
1914-15	...	96-1	91-8	83	77	...	...	...	...
1915-16	...	93-2	$79\frac{1}{2}$	80	$67\frac{1}{2}$	...	...	...	...
1916-17	...	82	69	70	59	...	...	...	...
1917-18	...	70	67	60	57	...	...	...	...
1918-19	...	81	65	69	58	93	90	...	...
1919-20	...	71	60	62	50	95	90	96	$95\frac{1}{2}$
1920-21	...	*60*	*52*	*50*	*42*	90	77	96	$78\frac{1}{2}$
1921-22	...	62	55-8	53	47	87	78	89	80
1922-23	...	61-4	55-8	52-8	47-12	88-8	81-6	93-8	87
1923-24	...	*63-3*	*61*	*57-12*	*51-14*	93-10	87-12	98-14	93-2
1924-25	...	68-6	63-4	58-10	53-8	94-14	92-14	99-8	97
1925-26	...	73-8	67-10	63-14	57-15	97-4	94-13	101-7	98-13
1926-27	...	79-1	74-6	67-14	63-8	102-6	99-14	110-4	104-9
1927-28	...	*79-5*	*74-6*	*67-14*	*63-14*	101-11	100-4	108-13	105-13
1928-29	...	75-10	71-14	64-12	61-8	100-8	99-2	106-11	103-4
1929-30	...	72-5	63-15	61-15	54-13	99-4	94-12	103-12	100-0

Points of improvement in 1927-28 over 1920-21 in the case of $3\frac{1}{2}$% and 3% stocks:—

	$3\frac{1}{2}$% max.	$3\frac{1}{2}$% min.	3% max.	3% min.
	19	22	18	22
In 1923-24 over 1920-21	3	9	8	10
In 1927-28 over 1923-24	16	13	10	12

[1] Compiled from the appendices of Financial Statements.

An examination of these tables shows that the worst position due to war was reached in 1917-18. Prices recovered in 1918-19 in the two countries, to fall rapidly again in the following two years. Unprecedentedly low points were touched by the sterling securities—all along the line—in the year 1920-21, and by the rupee securities in that and the following year. As would appear from a comparison of the quotations for 3½ per cent and 3 per cent sterling and rupee securities, the position at that time was worse in India than in England. An improvement then began which has continued more or less steadily since, except during the last two years (1928-29 and 1929-30) in which the prices of securities have again fallen owing to world-wide monetary stringency.

What have been the causes of this depression in the post-war years ? (i) For five consecutive years, from 1918-19 to 1922-23, there were budget deficits amounting to about 100 crores of rupees. (ii) Moreover, the 3 and 5-year War Bonds issued in the first (1917) and the second (1918) war loans fell due in 1920, 1921, 1922 and 1923. The 1915 four per cent rupee loan also fell due on maturity in 1923. (iii) Outstanding floating debt was at its highest peak in those years,

the amount of Treasury Bills being 52·98 crores of rupees on the 31st March 1920; 104·93 crores on the same date in 1921; 111·85 crores in 1922 and 71·23 crores in 1923. (iv) Rupee exchange touched its lowest points (1s. 3¼d.) in 1921-22 and 1922-23. (v) The balance of trade went against India in 1920-21 and again in 1921-22, the excess of imports of private merchandise over exports being 77·54 crores of rupees in the first, and 20·90 crores in the second year. (vi) Bank rate in England was at its highest (7 per cent) from the 15th April 1920 to 1st May 1921, a most unfavourable time for all gilt-edged securities. (vii) The years from 1919 to 1921 were a period of Afghan War, frontier troubles, political disorder, repression, and the non-cooperation movement. It was some time before a relatively calm political condition was recovered. (viii) Most important of all the reasons for the depression in the prices of securities, however, was the keenness of the demand for capital for all purposes, even at a high rate, on the partial release of restrictions on new capital issues.

In these circumstances, it is no wonder that there was a great depression in the prices of sterling and rupee securities in the years under consideration. So bad was the position in India,

that it occasioned a special debate in the Council of State in February 1921, and led to the appointment of two committees, one at Bombay and another at Calcutta, to enquire into the rehabilitation of rupee securities in India.

Since then, considerable improvement in the quotations has taken place, greater in India than in England, and, in this improvement, one very significant fact may be noted: The improvement was more rapid in England in the years 1921-22, 1922-23 and 1923-24—exactly the years in which heavy sterling loans were raised—than has occurred since; whereas quite the reverse was the position with regard to rupee securities in India. This difference is apparently the more inexplicable in so far as the same policy, viz., that of starving the money market for fresh loan paper, has been pursued in the two loan markets in the second of these intervals (1924-28). No fresh demand for money having been made in the open money market in India, the direct loan debt remained almost unchanged from 1925 to 1928. Similarly, no sterling loans were raised in the calendar years 1924, 1925, 1926 and 1927. It is thus a very regrettable feature of the situation that the prices of sterling securities in London have not

made a corresponding improvement with the prices of rupee securities in India. What it shows, however, is that in the long run, monetary conditions have been more stringent in London than in India. When the terms of new loans are decided upon, the prices of existing securities are taken into account. New borrowing, therefore, naturally becomes expensive, when the already issued paper stands low in the market. "Easiness and cheapness in borrowing," says Hilton Young,[1] "depend on the market valuation of the Government's outstanding stock; the lower the price of Government securities, the more expensive is it for the Government to borrow." It would appear, therefore, that the need exists for the administration of a heavy dose of some strong tonic if the position of Indian sterling securities in London is to be strengthened in the interests of future borrowings.

(ii) **Fixed-dated and Short-dated Loans.**—The practice of borrowing on fixed-dated terms was not new to the post-war period. It was started in the year 1910-11 when a $3\frac{1}{2}$ per cent loan of £4 million was contracted for on the promise of repayment in eight annual instalments. "I would

[1] "The System of National Finance," p. 282.

like to add," said Mr. Cole, then Governor of the Bank of England, in his evidence before the Chamberlain Currency Commission of 1913, "that if India at any time requires money on a large scale, she would probably have to issue a loan with a fixed date for redemption."[1] He thought Indian securities had gone down more than Colonial securities, the reason being the lack of a date of redemption in the case of the former. But the result, he further believed, was not adverse to India, as the price of other Trustee securities which were irredeemable was also down.

One of the most important reasons for the issue of terminable instead of non-terminable Indian loans is simply that India now raises much larger amounts at a time than before. In a period of falling prices, moreover, the natural tendency is to mark time ; short-period loans are the most advisable and the most advantageous until more propitious times for long-term funding operations arrive. The British Government has on many occasions during the last ten years renewed her short-dated debt by means of further issues of short-period Treasury

[1] Cd., 7069, 1913, Vol. I, p. 157, Q. 3368, and others.

Bonds. It may be noted that four out of the eight Indian sterling loans raised in the post-war period were short-period ones; the first, of £7½ million 7 per cent loan (1921), redeemable in 1926-31, which has since been converted into 3 per cent irredeemable stock[1]; the second, 5½ per cent £10 million raised in 1921 and redeemable in 1932; third, a second issue of £12½ million of the same stock raised in 1922; and last, the £6 million 6 per cent Bonds issued in February 1930 and repayable in 1932-33. Two loans of £40 million were raised at 4½ per cent in 1922-23 and the following year, which are repayable in 1950-55, and the remaining two of £17½ million, also raised at 4½ per cent, are repayable in 1958-68. These four loans represent a fairly long-period stock. It is an open question whether, in view of the easier money market conditions in India, earlier dates than 1950 and 1958 might not have been given as first option for redemption of the 4½ per cent sterling loans. In the case of some Dominion loans, the gap between the first optional date of redemption and the final date of repayment is sometimes as much as 30 years. It would have been

[1] For the terms on which this conversion was made, see below, p. 86.

worth while for the Government of India to have made an attempt to repay, at least a part of the recently contracted sterling debt, out of the rupee issues, as during the period from 1935 to 1945 there are very few maturing debts in India and practically none in London.

India Reaping Fruits of a Cautious Policy.— Let us, however, frankly acknowledge that India is reaping the fruits of the more cautious policy followed by her financiers in raising non-terminable loans before the war. India had no post-war sterling maturities to be renewed, as some other Dominions had. The Union of South Africa, New Zealand, and the various States of Australia have in recent years been required to convert a number of their pre-war $3\frac{1}{2}$ per cent, 4 per cent and other cheaper loans, into loans at a higher rate of interest. The Union of South Africa converted 4 per cent stock of the Cape of Good Hope into 5 per cent at $99\frac{1}{2}$ in 1923. In 1924 she converted £4 million 4 per cent debentures into 5 per cent inscribed stock at 99[1] and in the following year, £3 million $4\frac{1}{2}$ per cent stock and

[1] For details, see files of the *Economist*, from which these data have been extracted.

debentures were converted into 5 per cent stock at $99\frac{1}{2}$. The Dominion of New Zealand converted her £5·22 million four per cents into four and a half per cents at 95 in 1926. Similarly, New South Wales, Victoria, Queensland, and South Australia have had to carry out a number of large conversion operations in London whereby they have raised the amount of the interest bill on their previous pre-war debts. The result of these conversion operations must have been a heavier burden to the taxpayers of those Dominions.

It will be seen, therefore, that it was undoubtedly a privileged position for India to occupy that her interminable loans should have been absorbed by the London money market before the war without much difficulty. But in the post-war period, the fact is that a very long date of redemption sometimes jeopardises the success of oversea issues, however excellent the credit of the borrower. Referring to the failure of a South African 5 per cent 1945-75 loan of £6 million, issued at $98\frac{1}{2}$, *The Times* wrote (March 7th, 1930) that "the price was a little too high, but the fact that the borrower had an option over 30 years to redeem the loan before the final date, perhaps militated to some extent against the success of the issue. A 20-year option is long enough,

but 30 years is unusually long." On the whole, therefore, it may be affirmed that in issuing fixed-dated stock in recent years, India has brought herself into line with other Imperial borrowers, in her own interests no less than of her bond-holders. "In general," wrote the Colwyn Committee with regard to the future issues of the British Government loans, "so far as conditions permit, it seems to us sound policy to proceed in the main with issues of securities in funded form, with an option to the Government to repay at a not too distant date."[1] What is suitable for future British Government loans, must surely apply with even greater force to India's external capital issues in London.

(iii) **Heavier London Borrowings.**—Another alleged sign of the declining credit of India is her heavier post-war borrowing in London. The average of India's pre-war borrowings works out at about £4 million a year. In the post-war period, whether we take into consideration the amount of each individual loan or an average over a number of years, it cannot be denied that India has become a much heavier borrower. In the nine years from the year 1921-22 when

[1] Report, para 1008, p. 343.

re-borrowing started in London after the war, to 1929-30, India has raised no less than £93½ million by open market loans, besides taking over liability for another £22 million in connection with the E.I.R. and G.I.P.R. debentures. Loans alone thus show an average of £10½ million a year.

Now, what are the reasons for these heavy post-war borrowings in London? The fact is that all capital expenditure by the State on its various forms of property was held up during the war. The Acworth Committee Report (1921) recommended heavy capital expenditure on the rehabilitation and equipment of Indian Railways. Their views were endorsed in 1922 by what was called the Railway Finance Requirements Committee of the Indian Legislature, who recommended an annual expenditure of Rs. 30 crores on Indian Railways for a period of five years. In the second place, the difficulty of financing capital expenditure in India was further accentuated by the fact that the purchasing power of money fell considerably in the post-war period. Thus, the Railway Administration Report for 1920-21 states with regard to the purchase of railway materials, that in many cases the purchasing power of money fell to half of what it was before the war. Moreover, many

provinces needed loan money for their expanding needs. And over and above these, the Government and the Legislature in India decided to take over the direct management of old State Railways from the companies and buy others whose terms fell due during this period, as a result of which the Delhi-Umbala-Kalka, and Burma Railways have been bought out for £6 million. All these and many similar factors show that the Indian Government committed itself to heavier—much heavier—capital borrowings than were made before the war. There is no fault to be ascribed to the London money market in this respect. Heavy capital expenditure is a matter of policy. But heavier borrowings must have their influence on that market. It is a well-known fact that bond-holders in London go in for a good deal of specialisation in their investments in particular branches of securities. The statement may be hazarded that profits made therefrom are usually re-invested in the same fields. This is particularly true of those institutions that deal in foreign securities. A new investment, therefore, must have certain special features, before any set of bond-holders can be persuaded to include it in their portfolio, and unless new bond-holders are willing to take up a new

investment, or existing holders are in a position to absorb larger quantities of increased Indian capital issues, the terms at which the new loans take place must be left to the capacity, influence and discretion of the underwriters of Government loans. Such terms may or may not be favourable to India. Not that the underwriters can commit a fraud, but they must demand sufficiently attractive terms to put through successfully a large amount of Indian stock. Unless the exigencies of the political outlook, and the existing geographical distribution of funds advise the contrary, the situation of India in this respect must improve as soon as larger yields made from heavier recent investments will enable reinvestments to take place in that branch on a larger scale with a cumulative effect.

(iv) **The Undigested Loan of 1929.**— Much capital has recently been made of the fact that 23 per cent of the £10 million sterling loan of January 1929 went abegging, and had to be retained by the underwriters. But this is by no means a rare phenomenon in the London money market. In the previous December, a British Government issue fell short of requirements by £25 million. In the same month of January,

84 per cent of a £8 million Australian Commonwealth issue was left undigested by the money market. The underwriters of the recent £ 6 million 5 per cent Union of South Africa loan were called upon to take up 75 per cent of the amount.[1]

The money market is governed purely by economic forces, and the Indian Government cannot alter its course. As Sir George Schuster put it (in a letter to the Indian Merchants' Chamber), "the price which the Government can get is a matter which depends on the view which the investing public in London takes of the credit of the Government of India, and is a matter which neither I nor the Secretary of State can control. It is an unfortunate fact that for various reasons the credit of the Government of India in London in recent times has declined." In connection with an Austrian issue, of which 85 per cent of the amount remained undigested by the market early in the same year, the *Financial News* wrote as follows: "The poor response to the issue is held to prove that the name of an issuing house, however excellent, does not compensate for the unattractiveness of the

[1] *Vide*, *The Times*, March 7th, 1930.

terms of issue. The experience of recent years has shown that even the strongest group of well-established houses is unable to keep a loan at par if its terms do not appeal to the investing public."[1]

(v) **More Expensive Post-War Borrowings.**—The high rates of interest paid on loans, it is urged, also indicate a decline in credit. As we have already shown in an earlier part of this chapter, sterling loans in the post-war period have invariably been offered at more attractive terms than those paid for rupee loans in India in the corresponding years.

More expensive borrowing in London is, on the whole, a result of more stringent monetary conditions there than those that have obtained in India. London is an international monetary centre where all borrowers, home, imperial and foreign, have been affected by the high money rates prevailing in the post-war period. Depression in the prices of Indian securities in London, extensive short-term or heavy borrowing, the occasional failure of a loan due to a miscalculation of money market conditions, or the raising of loans at a high rate of interest

[1] *Financial News*, Jan. 29th, 1929.

do not thus necessarily indicate a fall in Indian credit. The true acid test is: Does the London money market observe any distinction to India's disadvantage in comparison with the capital issues of other imperial borrowers? We shall answer this question in the next section.

INDIA'S POSITION AMONG LONDON BORROWERS

In the previous section, we discussed some features of India's declining credit, and showed that as between India and London, the latter is distinctly more unfavourable, but the true relative position of India in London can only be determined by a comparison with other borrowers. The proposition that we set ourselves to examine now is: What is the position of India in London in comparison with such other imperial borrowers as New Zealand, South Africa, and Australia, or with the London County Council and similar borrowers, who are, or should be treated almost on the same footing as India in the London money market? But before we make a detailed comparison of Indian loans with those of other borrowers, let us first discuss an important advantage that India enjoys as a borrower in London.

Indian Borrowing Not a Favour.—The belief is sometimes prevalent in India that she confers a favour on the London money market when she comes in there as a borrower. There is no doubt that the loan by Britain of the required capital to India, or, for that matter, to any other less advanced country in the world, does result in the promotion of British industry and trade, but so far as the money market is concerned, Indian borrowings constitute only a small share of the total capital issues raised in the United Kingdom. Thus it has been calculated that in the period of 29 years, from 1900 to 1928, the Indian Government's net borrowings formed 1·1 per cent of the total capital issues, home and foreign, raised in the United Kingdom; 4 per cent of the total oversea issues, foreign and imperial; and 15 per cent of the total borrowings of the various oversea Governments of the Empire.[1] Occasional absence of the Indian Government

				£ m.
[1] Total issues in U.K.	...	...	...	10,884
Total oversea issues	..	...	...	2,927
Oversea parts of Empire	...	...	...	1,499
Empire Governments	...	...	...	784
Indian Government	...	...	...	123

These amounts represent net money taken during the period. *Vide* Appendices of "Imperial Finance" based on the *Economist.*

from the London money market does not necessarily mean a respite to that much oppressed market. Canada, perhaps, in her own interests no less than those of the London market, has altogether ceased borrowing in London since the war. During the war, that Dominion, like so many other parts of the Empire, financed her operations from her indigenous resources, but since then, she has partly met her requirements from her next door neighbour.

Advantages of Trustee Security Status.— It must be frankly acknowledged, however, that the enjoyment of trustee security status in Britain by Dominion, Colonial, Indian Government and Indian Railway Stocks means a great saving to the Empire countries in the rate of interest at which they can borrow, and far from being regarded as an unmixed blessing, there is sometimes a subtle feeling of resentment that some, at any rate, of the oversea empire borrowers take undue advantage of the preference accorded to them. To quote from the *Nation and Athenaeum* of January 12th, 1929: "The £10 million loan for India last week, and the £7 million cash loan for New Zealand this week, are a reminder that the Dominions and Colonies are

still taking full advantage of the 'preference' that is given them in the London money market. The preference stands because it is on the Statute Book. By the Colonial Stock Act of 1910, the loans of Colonial Governments were given on compliance with certain Treasury formalities the status of trustee securities, and by an earlier Colonial Stock Act, the share warrants and stock certificates to bearer of Colonial Governments escape the 2 per cent stamp duty imposed on transfers for one of 5s. per cent (formerly it was 2s. 6d. per cent). These statutes give the Dominions and Colonies an immense advantage over all other oversea borrowers. By virtue of them, the Government of a new country like Southern Rhodesia can raise money at 5 per cent while Czechoslovakia, which is much more economically developed, has to pay, say 8 per cent. The question must arise whether the preference extended to Dominion and Colonial loans should be continued, if by reason of our reduced savings our oversea lending has to be curtailed." On account of the heavy investment of funds in the loans of Governments and Corporations of Dominions and Colonies which is a reflexion of the influence of the Trustee Act, Sir Robert Kindersley was

making comparisons. Conditions in the money market change from year to year, month to month, nay from week to week, sometimes from day to day, and even from hour to hour. Thus we find that in January 1922 the British Government once issued Treasury Bonds at $5\frac{1}{2}$ per cent at 99 in the early part of the month, and at 5 per cent at 99 towards the end. Then there were several occasions on which India and Australia borrowed at different rates of interest within the same year. Mr. Alan Dale prepared an index of the prices of gilt-edged securities for the *Investors Chronicle* for some months of 1929 when the Bank Rate had twice risen by 2 per cent[1], and he came to the conclusion that from January 28th to September 30th the general index had fallen from 102 to 96·6. This phenomenon indicates a rise in the money rate for new borrowers. "High money rates," wrote a financial paper some time ago, "owing partly to the inducements they offer for the placing of money on deposit, and employing it temporarily in other ways, always react unfavourably on the market for stock exchange securities, particularly those of the

[1] From $4\frac{1}{2}$% to $5\frac{1}{2}$% on the 7th February and from $5\frac{1}{2}$% to $6\frac{1}{2}$% on the 26th September.

higher classes." Money market conditions, that is to say, are essentially variable phenomena, and the results of any comparisons must be accepted with due caution.

A Serious Error of Judgment.—In June 1921, India raised a short-term sterling issue at 7 per cent rate of interest at par. In the same month, New Zealand raised an issue of £5 million at 6 per cent rate of interest at the issue price of 96. A few months later in October, S. Africa raised a similar amount on exactly the same terms as New Zealand. Two issues of Local Loans Irredeemable Stock were made in the year, once at 6 per cent and again at £5-15-5 per cent. The highest price for money among other borrowers was paid by South Australia, who raised a £5 million loan at 6½ per cent at par in the same month of June when India paid 7 per cent. That in the case of this particular Indian loan there was a lapse, a serious error of judgment, cannot be denied. The terms were, in fact, so extraordinarily attractive, that the loan was immediately over-subscribed on issue; its market price at once rose above par, and has remained so since then. It could have been argued at the time on behalf of the Government that it had approached the

London money market not only after a lapse of many years, but at a very critical moment in the Indian political and financial situation, so that it was especially anxious to assure the success of the issue. A loan of that price in India would have further weakened the exchange, which was already on its downward course, and would have greatly depreciated the market price of the already existing rupee stock. Miscalculation regarding the rate of interest might have been condoned on account of the fact that in the previous financial year, the British Government had issued ten-year bonds, which, in certain circumstances, carried a 7 per cent rate of interest.[1] It is not our purpose, however, to defend the indefensible. The whole course of this loan from beginning to end appears as nothing short of a financial scandal. It carried the privilege of conversion into 3 per cent stock, and if redeemed before 1931, the promise of repayment at 102 per cent! Its very existence in the London money market constituted a kind of danger-signal to all future investors in Indian securities. £3·2 million of that loan was therefore converted into £6·46 million 3 per cent stock in

[1] Committee on National Debt and Taxation, p. 41.

1922-23, and £2 million was converted into £4 million 3 per cent stock in the following year, costing the Indian taxpayer a gratuitous increase of £5·26 million in the Indian public debt, quite an unprecedented transaction in the whole recent history of the Indian public debt. The situation, however, improved by the end of the year. But even the December issue was raised at more than 6 per cent effective rate of interest, whereas the Local Loans Irredeemable Stock was raised at the rate of £5-15-5 per cent in November, and the British Government Treasury Bonds at $5\frac{1}{2}$ per cent, at the issue price of 99 in the same month as the Indian loan.

In the calendar year 1922, two loans were raised for India, one in June at £6-1 per cent effective rate of interest, and another in October at $5\frac{1}{2}$ per cent net rate of interest. In April of the same year, New Zealand succeeded in raising money in London at 5 per cent rate of interest at par. Local Loans Irredeemable Stock was issued in January at the net rate of £5-5-3 per cent interest. The Commonwealth issue nearest to the Indian June issue was raised in April at a net rate of £5-4 per cent. Another Commonwealth issue near to the Indian issue of October was the Victorian September issue, on which

5 per cent interest was paid, Indian effective rate being $5\frac{1}{2}$ per cent.

In May 1923, while the Indian loan was raised at over 5 per cent effective rate of interest, the New Zealand issue was a success at £4-12-6 per cent. In spite of the fears then current that the terms of the latter might be unattractive, the lists closed within two days. These two borrowings took place in consecutive weeks. And yet there is a considerable difference between the rates of interest offered in the two cases. The South African loan in October was raised at practically the same price as the Indian issue in May. Some of the Australian loans which were raised much earlier than the Indian issue also paid practically the same price; but the issue nearest in time to the Indian loan, a West Australian issue in June, was raised at an effective rate of £4-15-7 per cent as against the Indian rate of over 5 per cent.

Coming to the year 1928, we find that while India offered a $4\frac{1}{2}$ per cent long-period stock at $91\frac{1}{2}$ per cent in January, New Zealand put one through at $94\frac{1}{2}$ in the following May, paying thereby exactly the same price as was paid by the London County Council in the same month. In the previous October (1927) and December (1927), South Africa and New South Wales had raised loans at

the rates of over 5 per cent, and £5-5-7 per cent respectively. The British Government issued its 5 per cent Treasury Bonds in December 1927 at 101. In March 1928 the Commonwealth of Australia raised an issue at £5-2-4 per cent effective rate, while the Indian rate for the January issue worked out at £4-19-11 per cent. In general, therefore, at this date, the Indian rate was distinctly favourable in comparison with those of South African and Australian, but unfavourable in comparison with the New Zealand and the County Council issues.

History repeated itself early in 1929, when, in January, India offered its long-period 4½ per cent stock at 91 (£5-0-7 per cent), while New Zealand obtained it at 95 (£4-16-5 per cent). It may be noted that while India's position worsened by half a point over her last year's issue, New Zealand's improved by an equivalent amount. The two Australian issues, however, of January and May respectively, were raised at over 5 per cent, and the first was a failure in the market, 84 per cent being left in the hands of the underwriters.

Summarising the position for all the loans we have considered, we find that New Zealand enjoys, by common consent, the highest credit

among the imperial borrowers. She has always secured better terms in London than any other borrower of similar standing. Between the rates she has been able to offer and the Indian rate, the difference has been at times nearly as much as one per cent. But that difference has tended to dwindle in recent years. India's status as a borrower was weakest in 1921 and 1922 when her position was worse than any of the other borrowers we have considered. With the 1923 loan, however, India retrieved her credit considerably, and became *almost* on a par with South Africa and Australia, and in the last two years under discussion (1927-28 and 1928-29), while she has fared worse than New Zealand and the London County Council, she has distinctly maintained a position better than that of South Africa and the Australian States.

New Zealand and Australia's Special Position.—One consideration of course detracts somewhat from the value of a comparison with New Zealand on the one hand and Australia on the other. While the one stands in London *par excellence* for the soundness of her finances, the other is notorious for her over-borrowing, and, to say the least, has been somewhat suspect at

times for her generous expenditure on her economic services.

New Zealand, for instance, is unique in having had budget surpluses to the extent of £30 million during and after the war.[1] And again, whereas in 1913, 18·8 per cent of her total debt was internal, by 1928 she had increased the proportion held internally to 55 per cent. New Zealand, moreover, probably of all the Dominions, has the strongest ties of kinship to the mother-country, and is free from controversies such as surround the cases of Australia or Canada.

Australia, on the other hand, has shown a regrettable tendency to over-borrow in recent years. In the 18 months ending in December 1928, she raised no less than ten foreign loans in the London and New York markets, amounting to £63·5 million, her average of foreign borrowing during the last few years has been £40 million a year. While since 1914 her production has increased only by 110 per cent, her debt has increased by 219 per cent (her present debt being £1,037 million), and during the last few years her exports have been much less than her imports.[2] These conclusions have since been confirmed by the

[1] *Vide Economist*, May 5th, 1928.

[2] Ibid., Dec. 15th, 1928.

report of the British Economic Mission that visited Australia in 1928, and issued its report early in 1929. The Mission has pointed out that between 1922 and 1927, the interest on Australian debt has risen from £39·78 million to £52·12 million out of which £25 million per annum is paid in London. The amount of interest available from revenue-producing assets is £24·4 million while the balance of £27·68 million is secured by taxation. The position is even worse in the separate States, where as much as 68 per cent of the interest is met by taxation and only the remainder by revenue-yielding assets. Australia's railways, again, are earning at present an average yield of only $3\frac{1}{2}$ per cent. For a new borrowing country, with a small population of only 6 million persons, all these are facts which are very disquieting, and they must necessarily have an adverse influence on her credit in her chief loan-market.[1]

India Merits as Good Terms as any other Borrower.—Whatever the special credit position of New Zealand or Australia in London,

[1] *The Pioneer* (August 31st, 1930) reports that the New S. Wales Labour Council has advocated the repudiation of Australia's war debt by the nation.

India, for the reasons that we have already urged, on account of the inherently strong position of her finances and the sound nature of her productive assets, deserves to be in a position to raise her loans in London on terms as good as, if not actually better than those offered by any other imperial borrower. In this respect, however, we find that New Zealand and the London County Council still lead the way. But we are inclined to agree for instance with the *Economist* [1] when it says that "the Indian Government has been able to take considerable advantage of cheaper money rates, *although whether to its fullest extent* may be questionable point." (The italics are ours.) India has definite advantages, but she has still to make up leeway before it can be said she has made the most of them.

The Congress Resolution and After.—Since the above was written, India's credit has received a rude buffetting in London owing to a repetition, at the Lahore Congress in Christmas last, of the threats of debt repudiation that had been uttered once previously at Gaya in 1921.

[1] October 28th, 1922.

But it must be remembered in this connection that most of the expenditure out of loan funds in recent times, even the war loan contribution to Britain of £100 million has been incurred by the Executive in India with the tacit or explicit consent of the representatives of the people in the Legislature. Any government, whether indigenous or alien, will have ultimately to redeem India's debt obligations, both external and internal, in full. The examples of Russia and some South American Republics are far too notorious for India not to take a lesson from them and to realise what threats of debt repudiation imply. Whether such an extreme form of political agitation has more than problematical value is not for us to say, but it is possible to be a true nationalist to the core without proclaiming oneself as a bad debtor. Such pronouncements create uncertainty and uneasiness in business circles, and a bad name in international affairs ; they bring about an immediate drop in security prices, encourage people to export their capital abroad, and lead to starvation of the home capital programme ; tend to raise the rate of interest at home, and make foreign borrowing much more expensive and, if persisted in, drive the foreign ruler to make his grip much stronger in financial matters. The saner elements in

Indian society will never countenance such a step. Although, indeed, the India Office issued a reassuring note for the benefit of investors in Indian securities, it is surprising that the Indian Legislature did not take some similar step in order further to strengthen the nerves of anxious investors.

The most injurious effects of the Congress resolution were the immediate drop in the prices of Indian securities, and the very heavy price paid by India in London for a short-term loan of £6 million raised in February last. While the British Government borrowed in the new year a loan at 4½ per cent at 95 (i.e., virtually on a 5 per cent basis), South Africa, New Zealand and a number of home corporations, including Hastings, Southampton, Belfast and Birmingham, put through their issues at prices ranging between 98 and par (Birmingham at 100½ per cent); India, on the other hand, had to pay as much as £6-12-3 per cent for her February sterling issue—she has not fared much better in the case of her £7 million May issue. The whole of this difference, however, cannot be attributed to the Congress resolution. It is now perfectly plain that an unnecessarily large degree of nervousness was exhibited by the authorities in last February, just as in 1921, in fixing the terms of this issue. "There is no doubt," wrote

a correspondent in the *Economist*,[1] "that this particular issue could have been made on a $5\frac{3}{4}$ per cent basis. It was heavily 'stagged,' it was more than six times over-subscribed, and it now appears that the Bank of England was prepared to accept these bonds as 'floaters,' that is, as equal security to British Treasury Bonds for borrowing purposes." It is not clear to us why the Government did not prefer to renew the old Bills for the time being, and chose instead to borrow on a two-year loan basis. The issue of the former, as will appear from a subsequent paragraph towards the end of this chapter, is distinctly cheaper than the latter, especially for short intervals of time; the British Government has been borrowing on Treasury Bills, week after week, during the past few months at about $2\frac{1}{2}$ per cent interest.[2]

Temporary Advances from G.S.R. Suggested.—Another more economical method to borrow under these circumstances, is to arrange to take temporary advances from the Gold Standard Reserve, say for a maximum period of three years to the extent of, let us say, £15 million. The Gold

[1] Feb. 22nd, 1930.

[2] *Vide* Budget Speech of the Chancellor for 1930.

Standard Reserve stood at over £22½ million on the 31st March 1913, and the original intention of the authorities then was to increase it up to a total of £25 million.[1] Now it stands at £40 million and is kept invested in London in British Treasury Bills and short-term Bonds. Rather than borrow on a short-term basis at the rate of 6 per cent and 7 per cent in London, it is much more economical for the Government of India to take temporary advances from the Reserve. India Bills and Bonds are usually treated as 'floaters' by the Bank of England. They are as good for the investment of the Reserve as the British Treasury Bills and Bonds. A temporary loan from the Reserve, in fact, was once taken by the Government of India on the outbreak of the war in 1914. In view of the large increase that has taken place in the amount of the Reserve during and since the war, such temporary advances would not very much weaken the position of the Reserve.

Tips for Advertising Loans in London.— Reverting, however, to the temporary shock to India's credit, we might say that this is only a passing phase of the situation. The atmosphere

[1] *Vide* Chamberlain Commission Report, paragraphs 86 and 97.

for Indian securities will gradually clarify on the improvement in the political situation. More permanent factors governing the supply of capital merit more serious attention. The success or failure of an Indian, or, for that matter, of any other similar sterling loan in London depends upon a variety of considerations besides the state of the political barometer. The condition of the State finances, the purpose for which money is needed, and the *locale* of the expenditure of that money; the size of the sum asked for, and the time at which the loan is floated; the prices at which the borrower's existing securities are quoted, the yields which other trustee securities give, and amount of the already existing debt—all these are factors of weight which are continually present. And in these respects, a little greater publicity in the financial papers on such points as the following would be of great value:

(i) The State Railways in recent years have been yielding over 5 per cent profits.

(ii) The period of recurring budget deficits is now well past.

(iii) Unproductive debt has been reduced by 70 or 80 crores of rupees during the last few years.

(iv) Of the capital raised in England, 90 or 95 per cent has been spent in England on the purchase of railway materials or for the payment of old railway stock.

(v) A Sinking Fund has been established in India on a statutory basis.

(vi) India has considerably increased the percentage of her debt that is held internally, during and since the war.

(vii) Money rates in India have recently been cheaper than in London.

(viii) That these rates and conditions have encouraged Indian investments abroad in recent years.

And this list could be extended. Such things are regularly mentioned in the loan prospectuses of some Dominions, and India would do well to take a leaf out of their book. Some of them give even greater details than is suggested above as to the state of their finances, for example, the total amount of Sinking Fund money held in reserve, or the amount of such funds used in the last few years in the purchase of securities in London. The latter operation, it is true, is sometimes employed with a view to bringing about an artificial increase in the prices of

existing securities immediately before a new issue is raised. But we wish to emphasise the fact that "tipping" of this character in the London money market sometimes proves of inestimable value to the borrower. The Indian Government spent £5,437 in advertising the sterling loans of 1923-24, and £2,835 in advertising the 1927-28 loan.[1] It is surely possible, if the expenditure of such sums is permitted, that some more systematic steps be taken to educate the investing public in London with regard to the true position of India's public debt.

Some General Observations on Sterling Debt.—A few observations of a general character may now be made with regard to the sterling portion of India's public debt. In the pre-war period, sterling loans were sometimes raised in advance of requirements, with the result that heavy sterling balances, not infrequently accumulated in London at the end of the year. As will appear from the following table giving the amounts of closing balances in London in the pre-war quinquennium and the quinquennium recently ended, the position has

[1] *Vide* Finance and Revenue Accounts of the Government of India.

distinctly changed for the better. A more efficient and economical use of the balances has been made, and they have been kept at very low figures in the latter period :

Amounts (in crores of rupees) of closing balances in London on the 31st March of each year.[1]

1909	... 12	1926	... 15
1910	... 19	1927	... $3\frac{1}{4}$
1911	... 25	1928	... $7\frac{1}{2}$
1912	... $27\frac{1}{2}$	1929	... [2]$7\frac{1}{4}$
1913	... 13	1930	.. [3]$6\frac{1}{3}$

Greater Coordination between Whitehall and Simla.—Before the war, there was insufficient coordination between the Home and the Indian authorities as regards the various amounts of capital raised in London. The Chamberlain Commission commented on this in referring to the flotation of a loan of £3 million in London in April 1912, when the closing balance on March 31st, 1912, stood at £18 million (the usual aggregate balance needed in London being only £4 million), and when market conditions were very

[1] The pre-war figures taken from the Chamberlain Commission Report are converted at Rs. 15 to the £; the post-war rupee figures are taken from the Financial Statements.

[2] Revised Estimate.

[3] Budget Estimate.

unfavourable for a new issue. It wrote: "In looking into this transaction, we have found some reason to doubt whether there is sufficiently close consultation between London and India as to the time and amount of particular borrowing operations. It is probable that in 1912 a larger amount than 3 crores might advantageously have been raised by a rupee loan in July, and a smaller amount than £3 million by a sterling loan in London in April." [1] Although the anachronism continues of issuing the Indian loans in the name of the Secretary of State for India and with the permission of the British Parliament, which latter bears absolutely no financial responsibility whatever for such transactions, the necessity, justification and circumstances of such external issues are entirely decided by the authorities in India. The Secretary of State for India now actually plays the rôle of a *residuary legatee* in respect of the amounts of capital to be raised in the two countries.

A development which appears to be of some importance in this connection is the care with which India Bills of a few months' duration have been issued in London during the

[1] Chamberlain Commission on Currency and Banking, para 192.

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last three years usually in the third quarter of the calendar year, in anticipation of permanent sterling loans early in the year, by which time the amount of available rupee resources becomes more or less fully known. The subjoined table confirms the above statement:

Year	Date of Issue of India Bills	Amount of Issue	Rate of Interest	Date of issue of permanent loans	Amt.	Rate %
1927-28	July 1927	£ 5 m. (6 months)	£4-9-9·33	Jan. 1928	£7½ m.	£4-19-0
1928-29	Aug. 1928	£ 6 m. (6 months)	£4-8-7·07	Jan. 1929	£10 m.	£5-0-7
1929-30	May 1929	£ 6m. (9 months)	£5-13-1·03	Feb. 1930	£6 m.	£6-12-3

Loans Now Underwritten.—Another change also has taken place in the method of raising loans in the post-war period. Whereas before the war the loans by the Secretary of State for India were raised by means of the tender system, they are now underwritten at a fixed price. Although the tender system is sometimes definitely cheaper than the fixed-rate method of loan issue, the latter is needed to attract greater popular support for larger loans. "Applications

by tender never attract popular support as do those which are invited for stock offered at a fixed price, and it is generally recognised that the former appeal only to what may be called professional financiers, i.e., bankers, discount houses, insurance companies and the Stock Exchange market. When the average investor outside financial circles makes an excursion into the field of tendering, he usually offers far too high a price and probably pays more than he would have done by purchasing the stock in the market after the allotment."[1]

Indirect Borrowing through Railway Companies Stopped.—Before the war, again, although the Government of India successfully resisted all temptation and pressure to increase the share-capital of railway companies, in spite of the recommendation for the adoption of such a course by Sir Thomas Robertson's Report of 1903 and the Mackay Committee Report of 1908,[2] the resources of the Secretary of State for India were frequently supplemented by the amounts of capital raised by railway companies in other ways. As the Acworth

[1] *Economist*, January 9th, 1909.
[2] Acworth Committee, p. 63.

Committee put it,[1] "the companies acted only as agents of the Secretary of State in the raising of capital by means of debentures, which, in fact, have been merely State loans under another name." The presence of a large number of Indian railway sterling securities of £122½ million issued in this way and subdivided into 63 different securities, no one of which was large enough to secure free dealing in the market, was considered by the Acworth Committee to be an obstacle to investment in Indian securities in the London money market. Loans in the post-war period, therefore, have been raised directly by the Secretary of State for India in the form of a few long-term stocks, and use of railway companies in London as the agencies for raising capital, even by means of debentures, has been done away with. Discussing the merits of the various methods of borrowing capital in London, the Mackay Committee thought direct government borrowing to be "unquestionably the cheapest method of raising money," and, "if sufficient can be thus obtained without materially lowering the price of the stock, there is little reason," they added, "to look to other methods." [2]

[1] Ibid.

[2] Mackay Committee, para 20.

Question of the Management of the Sterling Debt.—Before closing the chapter, it may be well to bring to notice an anomaly which exists in connection with the management of the Indian sterling debt. Canadian loans are issued in London by the Bank of Montreal, and the same institution manages the sterling debt of Canada in London. The same function is performed by the Commonwealth Bank of Australia in respect of most of the Australian public debt. Indian sterling debt, however, continues to be managed by the Bank of England, although the management of the London section of the Indian rupee debt has been transferred to the care of the Imperial Bank of India since 1922. Whatever might have been the advantages of having such arrangements with the Bank of England in the past, the case is now overwhelming for the transfer of such functions to the premier Indian banking institution in England. The sum involved as payment for the services of management comes to the respectable amount of over £85,000 a year. In the year 1923-24, it came to over a hundred thousand pounds.[1] The Imperial Bank of India in London may or

[1] Finance and Revenue Accounts.

may not have a large clientele interested in Indian securities, but depositors who have connections with the Bank of England and are unconnected with the Imperial Bank of India cannot claim any great difficulty in arranging transfers of money from other banking institutions whenever Indian sterling issues are launched in London. It is time, therefore, that the prejudice against relinquishing the prestige and glamour of the Bank of England's big name was overcome and the management of the Indian sterling debt handed over to the Imperial Bank of India, or to the proposed Federal Reserve Bank.

STATEMENT SHOWING THE GROWTH OF STERLING DEBT AND INTEREST THEREON IN MILLIONS OF POUNDS (STERLING)[1]

YEAR	Sterling debt	Interest charges in the preceding year	REMARKS
March 1914	177·06	...	
1915	176·19	6·07	
1916	175·17	6·18	
1917	174·14	5·34	
1918	236·95	9·93	62·94 due to British Government.
1919	202·52	8·40	33·41 paid over to Br. Govt.
1920	192·63	7·58	9·36 do. do.
1921	191·32	7·23	
1922	205·11	7·23	Sterling loans of 17½ m.
1923	242·63	8·65	(i) two sterling loans of 32½ m. (ii) 3·2 m. 7% converted into 6·46 m. 3%.
1924	263·80	10·26	(i) Loan of 20 m. (ii) 2 m. 7% converted into 4 m. 3%.
1925	341·04	12·65	(i) 60 m. for railway annuities shown. (ii) 18½ m. E. I. R. Debentures.
1926	342·19	13·07	3½ m. G. I. P. R. Debentures.
1927	339·08	13·04	
1928	344·39	13·12	7½ m. sterling loan.
1929	352·54	13·39	10 m. do.

[1] Extracted from the Finance and Revenue Accounts of the Government of India.

CHAPTER III

PROVINCIAL DEBTS

So far, we have concerned ourselves with a discussion of the various aspects of the public debt, mainly from an all-India point of view. Let us now review the position of the Provincial debts. These, though of very recent origin, have none the less developed sufficiently marked tendencies in a decade to lend themselves to scientific treatment. Although important local bodies such as the Presidency Corporations and the Port Trusts have long enjoyed the power of independent borrowing, both in India and in England, the Provincial Governments have only since the Government of India Act, 1919,[1] been empowered to raise loans in the open market, a privilege which, prior to the Reforms, was reserved to the Government of India.

First Rumblings of Decentralisation.—The whole question of giving borrowing powers to the Provincial Governments was considered by the Decentralisation Commission in 1908.[2] Those who

[1] Section 30 (1 a).

[2] Report, paras 104-109.

favoured the grant of such powers, argued before that Commission: (i) that the Provincial Governments would tap fresh local markets, the existing markets for Imperial loans being practically confined to Bombay and Calcutta; (ii) that the Provincial Governments could raise money for important projects when it was not possible for the Central Government to assist them; (iii) "that while the Government of India loans are usually confined to productive purposes, i.e., are raised for railways and irrigation works which are expected to yield a net return that will more than cover the interest on the money borrowed therefor, it might also be desirable to borrow for purposes which are financially unremunerative but of administrative importance."[1]

On the other hand, some witnesses opposed the idea. (i) They expressed doubts as to whether any fresh sources would be tapped by the provinces. They apprehended that if provincial borrowings took place in the same market, the Central Government loans would be disturbed. The Government of India did all it could to raise money, and it could better judge the probable yield of the money market than individual

[1] Ibid., para 105.

provincial governments. (ii) They pointed out that the provincial governments had no separate sources of revenue on the security of which to borrow. "The local governments will have to pay more for their loans than the Government of India, and it is cheaper therefore for the latter to conduct borrowing operations. This, indeed, is recognised by some witnesses, who suggested that loans should be raised by the Government of India on behalf of the provincial governments." (iii) Lastly, they feared *that the provincial* governments would generally borrow for financially unproductive purposes, and would add, therefore, to the dead-weight debt. The services under their control, it was maintained, should be financed out of current revenues, or current balances. In the event of calamities such as famines or floods, the Government of India might well be looked to to help the provinces in rendering relief.

After carefully weighing all the pros and cons of the matter, the Commission held "it undesirable that provincial governments should borrow any large sums in the open market. That is a function which ought to remain in the hands of the Government of India."[1] In cases,

[1] *Ibid.*, para 107.

however, in which the provincial governments were unable to provide from their current resources for costly 'non-productive' works of manifest utility, they recommended that the Government of India should advance the money in the first instance, recovering it from the provincial governments in short-term instalments.

A Corollary of Montford Reforms.—There the matter stood for ten years till the position was again reviewed at the time of the Montagu-Chelmsford enquiry in 1918. In the circumstances of the then rather undeveloped condition of the money market in the different provinces, it is doubtful whether much good would have resulted if powers of borrowing had actually been granted to the provinces in the first decade of this century. Much had happened since 1908, however, and during and after the war, the state of affairs had considerably changed for the better. As a result of the administrative decentralisation and the consequent separation of central and provincial revenues under the 1919 Reforms, certain assets such as irrigation works, in which borrowed money was invested, were handed over to the provinces, and it was only fair that the debt obligations should go

with those assets. When the latter were handed over to the provinces, their further development was a necessity, as all capital expenditure had been held up during the period of the war. That the provinces needed borrowed money for that purpose was indisputable ; how that money could best be obtained was the problem.

"We think," observed the framers of the Report,[1] "that in order to avoid harmful competition, provincial governments must continue to do their borrowing through the Government of India." But it was represented to the joint authors of the Report that local sources existed which could be tapped by the provincial governments, but were not touched by the all-India loans. "If the Government of India," this section of the Report continued, "finds itself unable to raise the money in any one year which a province requires, or if there is good reason to believe that a provincial project may attract money which would not be elicited by a Government of India loan, we would allow the Provincial Government to have recourse to the Indian market. But in that case we think that they should secure the approval of the Government of India to the method of borrowing,

[1] Montagu-Chelmsford Report, para 211.

including the rate of interest, so as not to affect investments in the post office, and the time of borrowing so as not to conflict with Indian loans." Even before the Decentralisation Commission of 1908, many of those witnesses who favoured the grant of borrowing powers to the provinces had admitted that some control of the Central Government was necessary over the provinces as regards the amount of loans, the time of their flotation, the rate of interest to be paid, the period of repayment of such loans, their competition with one another, and with the Central Government issues.

Local Government Borrowing Rules have now been framed under the Government of India Act laying down the purposes for which, and the conditions under which, loans may be raised by the local governments. "Rule 3 of the Local Government Borrowing Rules confers on the Government of India such powers as are necessary to secure the coordination of public issues of the several governments in India, and to minimise the disadvantages of competition between the various borrowing authorities. In cases where it is considered impolitic for a local government to raise a loan in the open market, or where a local government has not the advantage of a

borrowing market of its own, the Central Government generally comes to the assistance of the local government by the grant of advances from its own resources."[1] Thus the provincial governments, whenever they cannot meet their loan requirements out of their accumulated cash or revenue balances, or from the Famine Insurance or other Reserve Funds, have now two avenues open to them in order to finance their capital programmes :

(a) advances from the Government of India ; and

(b) direct loans.

Position on the Eve of Reforms.—The two subjoined tables give an idea of the provincial debt liabilities when they were taken over by the provincial governments on the 31st March 1921, the date on which a more or less complete separation of central and provincial finances took place, and on the 31st March 1928, the latest date for which complete detailed figures published in the annual Finance and Revenue Accounts of the Government of India are available :

[1] Finance and Revenue Accounts, 1927-28, p. 603.

PROVINCIAL LIABILITIES, 31ST MARCH 1921

(In crores of rupees)

Provinces	(a) Due to the Central Government: Provincial Loan A/c	Irrigation capital	Other advances	(b) Direct loans	Total
Madras ...	1·09	8·75	...	...	9·85
Bombay ...	3·21	8·91	...	9·38	21·50
Bengal ...	...	1·18	...	...	1·18
U. P. ...	2·96	12·19	...	..	15·16
Punjab ...	...	21·85	...	...	21·85
B. & O. ...	·70	5·98	...	...	6·68
C. P. ...	·92	3·71	...	...	4·64
Total ...	8·88	62·57	...	9·38	80·86

Advances from the Central Govt. ... 71·49 crores.
Total open market loans ... 9·38 „

PROVINCIAL LIABILITIES, 31ST MARCH 1928.

(In crores of rupees)

Provinces	(a) Due to the Central Government: Provincial Loan A/c.	Irrigation capital	Other advances	(b) Direct loans	Total
Madras ...	·43	8·75	6·93	...	16·12
Bombay ...	1·31	8·90	39·47	9·38	59·08
Bengal ...	...	1·18	1·29	...	2·48
U. P. ...	1·21	12·19	8·05	4·19	25·65
Punjab ...	...	21·86	1·56	2·78	26·22
Burma ...	...	...	·75	...	·75
B. & O. ...	·12	5·98	·31	...	6·41
C. P. ...	·25	3·71	2·01	...	5·98
Total ...	3·32	62·57	60·37	16·35	142·71

Advances from the Govt. of India ... 126·34 crores.
Direct loans ... ... 16·37 „

Note.—The provincial advances rose by another 11·18 crores in 1928-29 and by 4·93 crores in 1929-30. The debt on the 31st March, 1930, therefore, stood at 158·80 crores of rupees.

Provincial Loan Account.—The first item in the provincial debt is the Provincial Loan Account. This account was first started in the year 1888 and maintained by the Government of India. Its object was to provide money to be loaned out to provinces in small amounts annually, in order to enable them to finance expenditure by local bodies, and the agricultural loan operations. The future financing of this account formed one of the subjects of investigation by what is known as the "Financial Relations Committee" (1920) presided over by Lord Meston.[1] It was recognised by this committee that joint accounts of this nature between the provinces and the Government of India should be wound up as quickly as possible. The committee therefore recommended that the amount outstanding on the 31st March 1921, should be liquidated by the provinces, within a maximum period of twelve years, out of their current balances and revenues. The provinces of Bengal, Assam and the Punjab forthwith redeemed this liability out of their accumulated balances with the Government of India. The Burma Government also paid off the Government of India by means of a loan

[1] *Vide* Financial Relations Committee, chap. v, paras 31-35.

from its Rice Control Profits Fund. By other provinces it was " funded " at an average rate of interest, to be repaid in instalments to the Central Government within a period of twelve years.

An Obvious Injustice to Provinces.—We submit that the amount shown as due on this account should never have been made a provincial debt liability. It was pointed out by the Madras Government at the time,[1] that "a considerable part of the money upon which the provinces pay interest to the Government of India consists really of balances belonging to the provinces themselves." On the strength of the argument on which the Madras Government then took their stand, but were overruled by the Meston Committee and the Government of India, this amount of 8·88 crores and odd should have come to the provinces not as a debt liability, but as an accumulated fund built largely out of their own resources. The initial mistake committed by the Meston Committee therefore was to treat this amount in the category of debt. Now that the financial relations between the

[1] *Vide* Continuation Cmd., 974-1920, p. 27, para 10.

Central Government and the provinces are once more in the melting-pot, in equity and justice, the debt due by provinces to the Central Government in connection with the Provincial Loan Account as it stood on the 31st March 1921, should be re-transferred to the Central Government. This step will mean a relief to the provinces of at least $45\frac{1}{2}$ lakhs of rupees annually as a saving in their interest charges.

Another mistake committed in connection with the account was to stipulate its redemption within a period of twelve years. The next best thing to do was to fund it as a permanent obligation of the provinces along with the pre-reform "Irrigation debt." This arrangement for the liquidation of the Provincial Loan Account in a stipulated number of years could be understood if the provinces were not going to borrow any more money from the Central Government, but actually we find that the heavy increase in the provincial debt has taken place largely in that way. As the Government of India during the interval has borrowed money at sufficiently high rates of interest, fresh advances to the provinces have been made, or conversion of the old ones has taken place at correspondingly high rates of interest.

The stipulation that the Provincial Loan Account should be liquidated within twelve years has thus entailed a process of conversion from a low to a high rate of interest. In a subsequent paragraph we shall see that the rate of interest on all the advances by the Central Government to the provincial governments, works out at 3·31 per cent in the year 1921-22, and at 6·06 per cent in 1927-28. In all the intervening years, fresh advances have been made at a much higher rate of interest than that of 1921-22. The result of this process of conversion has been a heavy burden of interest charges on the provinces, entailing an unwarranted increase in the interest liabilities which can be estimated at nearly 13½ lakhs of rupees annually. We therefore suggest that the Provincial Loan Account, which has thus been converted from a low interest-bearing burden to one yielding a higher rate of interest, should be reconverted to 3·31 per cent rate of interest, i.e., to the average rate paid in the year 1921-22, if the amount cannot be actually written off altogether.

Pre-Reform Irrigation Capital.—The second column in the table on page 116 shows the amount of pre-reform irrigation capital. This

amount of 62·57 crores remained unchanged from 1921 to 1928, as under the reforms no distinction was observed between advances to provinces for irrigation and for other purposes. The importance of this unchanged figure, however, lies in the fact that according to Devolution Rule 24, the rate of interest to be charged on capital which was invested in irrigation works up to the year 1916-17 is fixed at 3·3252 per cent. This amount of pre-reform irrigation capital is therefore one which carries a low rate of interest.

Provincial Borrowing Since the Reforms.—The third column in the second table on page 116 shows the other loans and advances taken up by the provinces from the Government of India since 1921. These advances amounted to over 60 crores of rupees up to March 1928, and to 71 crores of rupees up to 1929. The following table showing the net advances taken by individual provinces from the Government of India year by year between 1921 and 1928 brings out some interesting points. The amounts stated are net, after deducting repayments made to the Government of India in those years, and minus figures represent net repayments made to the Central Government for previous outstanding advances:

EWING CHRISTIAN COLLEGE ALLAHABAD

ADVANCES FROM GOVERNMENT OF INDIA TO INDIVIDUAL PROVINCES—1921-28[1]

(In lakhs of rupees)

Provinces	1921-22	1922-23	1923-24	1924-25	1925-26	1926-27	1927-28
Madras	105·35	51·94	15·56	108·50	58·34	168·00	119·79
Bombay	370·00	736·19	995·58	675·01	583·48	191·51	211·00
Bengal	50·00	49·83	−4·34	−4·63	18·57	2·22	18·30
United Provinces ...	−25·5[2]	−25·00	78·89	123·81	174·53	201·09	101·95
Punjab	100·38	132·01	-100·38[2]	−1·26	−1·30[2]	−1·39	28·02
Bihar and Orissa ...	−4·56	15·24	2·02	−·21	−25·44	−6·97	−7·30
Central Provinces ...	42·60	−13·34	24·80	−1·92	−11·88	23·95	69·96
Assam	...	12·67	...	−12·67	...	...	...
Burma	...	...	...	...	...	...	75·00

[1] Compiled from the Finance and Revenue Accounts of the Government of India.

[2] Indicates years in which the provinces concerned took direct loans.

The above table clearly indicates that the needs of the different provinces for loan funds are very unequal. They are neither regular nor uniform. Bombay, the United Provinces, Madras and the Punjab, and to a certain extent the Central Provinces may be regarded, however, as borrowing provinces, and these, in fact, are the provinces that have schemes of irrigation works in hand. The following table sums up the debt position in the different provinces at the end of 1927-28:—

PROVINCIAL DEBTS—1921 & 1928

(In crores of rupees)

Province	31st Mar. *1921*	31st Mar. *1928*	Excess in *1928*
Bombay ...	21'50	59'08	37'58
United Provinces ...	15'16	25'65	10'49
Madras	9'85	16'12	6'27
Punjab	21'85	26'22	4'37
Central Provinces ...	4'64	5'98	1'34
Bengal	1'18	2'48	1'30
Burma	...	0'75	0'75
Bihar & Orissa ...	6'68	6'41	−0'27

We observe that the heaviest increase in the debt has taken place in the case of Bombay, whose debt rose by $37\frac{1}{2}$ crores of rupees from 1921 to 1928, or grew nearly sixfold from 1920 to 1928. (The direct loan of over 9 crores was raised by Bombay in 1920-21.) Next, though at a respectable distance, come the United Provinces, which increased their loan liabilities by about $10\frac{1}{2}$ crores of rupees, to be followed by Madras and the Punjab, whose increases amount to $6\frac{1}{4}$ crores and $4\frac{1}{3}$ crores, respectively. Others that have borrowed more than a crore in the post-reform period are the Central Provinces and Bengal. Burma has also recently taken an advance of 75 lakhs of rupees. Assam's loan was a small one, repaid in two years.

Thus we find that the debt is very unequally distributed among the provinces, the first four provinces alone being responsible for as much as 127 crores out of a total of $142\frac{3}{4}$ crores of rupees, and these same provinces (Bombay, U.P., Madras and the Punjab), it may be noted, have increased their proportion of the total from 84 per cent in 1921 to about 90 per cent in 1928.

An important fact to observe in connection with these advances is the rate of interest at which they have been made. As we have

already mentioned, according to Rule 24 of the Devolution Rules framed under the Government of India Act, the rate of interest on Irrigation outlays up to the end of the financial year 1916-17 has been fixed at 3·3252 per cent, and on outlays made in subsequent years, at the average rate of interest paid by the Governor-General-in-Council on loans raised in the open market. Thus, on the subsequent advances, the rate has varied from time to time in accordance with the conditions under which the Central Government has borrowed money in the open market. The following statement, prepared with the help of figures extracted from the Finance and Revenue Accounts of the Government of India, shows, on the basis of the actual amounts paid, at what rates of interest subsequent advances have worked out :

RATES OF INTEREST ON PROVINCIAL ADVANCES—1921-28

Year.	Amount of advance on 31st Mar.	Interest paid in the preceding year	Increase of advance over March 1922	Excess of interest charge since March 1922	Average rate of interest on advances since March 1922
	crores	lakhs	crores	lakhs	per cent
March 1921	71·49	...	...	...	...
1922	77·88	258·41	basic year		3·31 in 1921-22
1923	87·48	302·00	9·6	43·59	4·54
1924	97·56	375·47	19·68	117·06	5·94
1925	106·42	421·54	28·54	163·13	5·71
1926	114·38	520·14	36·50	261·73	7·17 12·38 % on new advance.
1927	120·17	536·12	42·29	277·71	5·56
1928	126·34	549·28	48·46	290·87	6·0
			185·07	1154·09	6·23 average for the whole period.

On the 31st March 1922, the amount owed by the provinces to the Government of India stood at 77·88 crores, and the interest paid thereon in the financial year 1921-22 amounted to 258·41 lakhs of rupees or the equivalent of 3·31 per cent. Taking 1921-22 as the basic year, we find that the rate of interest on fresh advances in subsequent years rose a great deal, reaching a maximum of 7·17 per cent in the year 1925-26. Since then, the average rate has fallen to 6 per cent during the last year under consideration.

The increase of interest charges in 1925-26 over the preceding year is very heavy, and it appears as if fresh advances in the year 1925-26 were made at a rate of 12·38 per cent, but possibly arrears of interest due in one year may have been paid by provinces in subsequent years. Another possible explanation of this increase may be the change of dates that had recently taken place as regards interest payments on advances from the Central Government.

We have therefore taken an average for the whole period of six years from 1922 to 1928, and the result is an average rate of interest of 6·23 per cent paid over the whole period. Our object in submitting to a critical examination the figures of the rate of interest paid on the

advances made to the provincial governments under the reformed regime, is to show how unhappy have been their circumstances as regards the terms and conditions under which provincial debt has increased, and this figure alone is significant in this respect.[1]

Direct Loans.—If we now review the position of the debt incurred by means of direct loans, we find that while the rate of interest at which the provincial governments have arranged advances from the central government, has undoubtedly been heavy, the interest and incidental charges for the direct borrowings of the provinces have been still heavier.[2] Out of a total provincial

[1] In order to avoid any possible misunderstanding, it may be mentioned here that the percentage rates of interest as shown above are based on the present writer's own calculations, worked out by taking as basic figures the amount outstanding on the 31st March, 1922, as capital and the amount paid *in the previous year as interest. According to the Finance and* Revenue Accounts of the Government of India, the rate charged on advances to the Provincial Loans Fund was 5½ per cent in 1925-26, and 4¾ per cent in the years 1926-27 and 1927-28. It is not clear whether those rates applied to the total advances standing to the debit of the fund or only to fresh advances made in those particular years. If the former is the case, the interest charges paid by the provincial governments to the Central Government should have been much less.

[2] A Statement giving the terms of direct provincial loans is appended to this chapter.

debt of 142·71 crores of rupees on the 31st March 1928, only 16·37 crores were raised by means of direct loans. Bombay raised a tax-free loan of 9·38 crores at $6\frac{1}{2}$ per cent on the eve of the introduction of the Reforms in 1920-21; the United Provinces raised another tax-free loan of 4·19 crores in the following year at 6 per cent at the issue price of 93 (thus starting with an unreceived initial dead-weight liability of over 28 lakhs of rupees), and the Punjab Government, two small loans, one of 1·90 crores in 1923-24 at $6\frac{1}{4}$ per cent and another of 88·11 lakhs in 1925-26 at $5\frac{3}{4}$ per cent. No sterling loan was incurred by any province, although the power to borrow in London is granted by the Rules. This, however, may on the whole be regarded as satisfactory. A distinguished ex-civilian privately expressed his view to the present writer that provincial loans would not have been successful in the London money market. Dr. Slater agrees with this view. Whether they would have been successful or otherwise, however,—and recent experience of Australia tells us that a multiplicity of borrowing authorities makes confusion worse confounded in the London money market—it hardly appears advisable that provinces should come to the London money market in order to

incur only small sterling obligations. The London money market should be reserved for the Government of India loans to the exclusion of all other public bodies, including the Presidency Corporations and the Port Trusts which at present carry small sterling obligations.[1]

We have already referred to the calculated rate of interest paid since 1921 on the advances made from the Central Government. The following table, based on the figures extracted from the Finance and Revenue Accounts of the Government of India, shows the calculated average rate on the direct loans :

Year	Amount of debt outstanding at the end of the year	Amount of interest and other charges paid during the year	Average rate of interest paid
	(in crores)	(in lakhs)	per cent
1921-22 ...	13·58	97·06	7·14
1922-23 ...	13·58	92·81	6·83
1923-24 ...	19·50	94·78	6·11
1924-25 ...	15·50	105·51	6·80
1925-26 ...	16·24	106·70	6·57
1926-27 ...	16·38	110·37	6·73
1927-28 ...	16·37	110·10	6·78
Average for the whole period ...	107·15	718·33	6·70

[1] See p. 11.

Direct Borrowings by Provinces More Expensive.—Taking the average rate at 6·7 per cent for the whole period, we find that this is about ½ per cent more than the rate at which advances have been made by the Central Government. Direct borrowings by the provinces from the money market have proved very expensive on account of the heavy discounts, brokerage, cost of debt-management, expenses incurred in connection with the loans, payments made to the Government of India for the tax-free loans,[1] and other miscellaneous charges. In the above table, the amount of interest paid in different years includes all other charges, but excludes provision for sinking funds.

There was no occasion on which the various provincial governments competed with one another in raising loans in the same money market. But a comparison of the terms, at which the provinces borrowed with the terms at which the corresponding rupee loans of the Central

[1] These occurred only in 1922-23 and 1923-24. In the year 1922-23, the Bombay Government paid Rs. 5,59,995 and the U. P. Government Rs. 2,19,302 to the Government of India for the tax-free nature of their loans. In the following year, only the U.P. Government made a contribution of Rs. 2,30,828 under that head. Charges of a similar nature do not since then appear in the Finance and Revenue Accounts of the Government of India.

Government were made in the same years, leads us to the conclusion that the "change from a system of cheap borrowing on a large scale to more expensive borrowing on a small scale"—the disadvantages of which the late Sir (then Mr.) William Meyer, a member of the Decentralisation Commission, appeared to have anticipated[1]—has, on the whole, not proved more economical than coordinated borrowing by one authority. The following statement bears out this contention :

COMPARISON OF THE TERMS ON WHICH PROVINCIAL AND CENTRAL GOVERNMENT LOANS WERE RAISED IN THE SAME YEARS

(In crores of rupees)

Year	Provincial Loans				Ind. Govt. Loans			
	Amount	Rate of interest	Issue price	Redemption date	Amount	Rate of interest	Issue price	Redemption date.
1920-21	3·38	6½%.T.F.	par	1930-35	29·34	6% T.F.	par	1930
1921-22	4·19	6%T.F.	93	1926-31-41	49·20	6% T.F.	par	1926-31
1923-24	1·90	6¼%	par	1933	14·17	5% T.F.	97	1933
1925-26	·88	5¾%	par	1937	4·73 [2]	5%	98½	1935

[1] *Vide* Q. No. 5859, Decentralisation Commission.

[2] The amount given above for the all-India rupee loan for 1925-26 represents only one section of the loan.

We find that every provincial loan was raised on much more onerous terms than the corresponding all-India rupee loan of that year. It may be of interest in this connection to examine if there was room for advances to provinces from the Central Government funds in the particular years in which direct loans were raised by the provinces; and the following statement shows the budgeted amounts of rupee loans and the actual proceeds thereof with the necessary remarks:

BUDGETED AMOUNTS AND ACTUAL PROCEEDS OF RUPEE LOANS

(In crores of rupees)

Year	Budgeted amount[1]	Actual yield	Remarks
1920-21	15	29·75	
1921-22	15	49·20	
1923-24	25	24	Fixed sum of 24 crores was wanted.
1925-26	12	30·61	All this was a conversion loan.

The above table shows that in the four years in which separate loans were raised by provinces,

[1] *Vide* Financial Statements, 1920, para 47; 1921, para 39; 1923, para 47; and 1925, para 71.

the Central Government, with one exception only, raised from the market in the loan season more than the sum it originally intended at the time of the budget. So far as the situation in the past is concerned, therefore, we are justified in concluding that the provincial governments could have been accommodated by the Central Government on cheaper terms than those that the provinces were in a position to obtain for their direct borrowings. The Bombay development loan of over 9 crores was floated in 1920-21, when the Central Government budgeted for a rupee loan of 15 crores and got nearly double the amount. In answer to a question put in the Council of State by the Hon. L. Ramsaran Das on the 5th September 1921, Mr. Cook, Financial Secretary, admitted that the amount of money received for that year's loan was more than was anticipated. Thus, given a strict attempt on the part of the Government of India to adhere to the previous financial forecast, a separate direct loan by the United Provinces could perhaps have been avoided in that year. As it was, as we have already shown above, the latter was raised on very expensive terms, and a considerable part was used to pay the Government of India not only in that, but also in the

following year.[1] Then in 1923-24, a fixed sum of 24 crores was wanted and obtained by the Central Government. In that year, the Punjab Government raised 1·9 crore by their own bonds, and more than half of this was paid to the Central Government in the same year. In 1925-26, the Central Government budgeted for a loan of 12 crores, but raised over 30½ crores. Writing from Calcutta, the local correspondent of the London *Economist* stated: "Government now monopolise the loan market, and could raise this year 20 to 30 crores without difficulty, whereas, apart from conversion operations, they are asking less than 5 crores and require this to pay off various sterling securities."[2] It is difficult, therefore, to believe that the amount of 88 lakhs of rupees which the Punjab Government raised by a separate issue of 5¾ per cent bonds in 1925-26 could not have been arranged for through the Central Government at a cheaper rate in that or the following year.

Enormous Increase in Capital Expenditure.—While the rate of interest paid by the provinces on the loans and advances has been

[1] See Table, p. 122. [2] *Economist*, July 3rd, 1926.

high during this period, the expenditure of loan funds has taken place in the provinces with rather a free hand. Before the introduction of the 1919 Reforms, large amounts of money were provided out of the revenues for the purpose of expenditure on public works, productive, protective and minor works, railways as well as irrigation. In the past, a very cautious and conservative policy had been pursued by the Government of India with regard to the use of loan funds for such objects. But restrictions in this respect have been considerably relaxed since the grant of new financial powers to the provinces. The effect of the latter has been that capital expenditure out of loan funds has made its appearance under an increasing number of heads ever since the provincial administrations have been allowed to spend money out of such funds on the fulfilment of the rather elastic condition that such expenditure should result in the creation of permanent assets of a material character.

Each Capital Head Analysed.—Before the Reforms, irrigation works were the only form of provincial capital asset. But changes were rapid after 1921. The ball was set rolling

with the creation of a Development Department by the Bombay Government in the financial year 1920-21. New capital heads were created under Civil Works in Madras and the United Provinces, under Forests in the United Provinces and Bombay, and under Public Health in Bombay, in the very first year under the Reforms. Agricultural Improvements in the United Provinces, Hydro-electric Scheme in the Punjab and "Other Provincial Works" in the United Provinces, Madras and Bombay, were added in the following year. In the year 1923-24, Madras and the Punjab started a new form of capital expenditure under the head of "Industrial Development," and 1926-27 saw the addition of the "Commuted Value of Pensions" by Bombay, the Punjab, Bihar and Orissa, the Central Provinces and Assam. The subjoined statement based on the Finance and Revenue Accounts of the Government of India, reveals very clearly the growth of capital expenditure in the provinces under the new dispensation.

STATEMENT SHOWING THE GROWTH OF CAPITAL EXPENDITURE IN THE PROVINCES AT THE END OF EACH OF THE FOLLOWING YEARS

(In lakhs of rupees)

Group A	1921-22	1922-23	1923-24	1924-25	1925-26	1926-27	1927-28
Agricultural Improvements	...	·20	1·14	1·45	1·69	4·22	5·18
Civil Works	13·97	74·99	1,51·94	2,69·24	4,41·10	5,83·65	7,17·86
Commuted value of pensions	...	...	...	...	...	46·02	61·99
Forests	3·09	8·73	14·75	28·55	44·30	51·93	56·07
Industrial Development ...	...	...	·61	22·8	3·30	50·16	37·54
Other Provincial Works ...	...	59·39	73·43	69·58	42·06	64·74	69·60
Public Health	3·50	9·57	10·34	12·71	22·81	21·13	26·85
Total ...	20·56	1,52·88	2,52·21	3,83·81	5,55·26	8,21·85	9,75·09
Yearly Increase (i) ...	20·56	1,32·32	99·33	1,31·60	1,71·45	2,66·59	1,53·24
Group B							
Bombay Development ...	3,74·27	6,39·78	8,87·48	10,45·39	11,22·12	11,67·10	11,75·97
Hydro-electric Development	...	·91	1·78	2·88	5·45	26·92	70·23
Irrigation	74,49·29	77,72·63	82,38·20	86,44·60	92,59·35	1,00,86·05	1,07,97·68
Total ...	78.23·56	84,13·32	91,27·46	96,92·87	1,03.85·92	1,12,80·07	1.20,43·88
Yearly Increase (ii) ...		5,89·76	7,14·14	5,65·41	6,94·05	8,93·15	7,63·81
Total of (i) and (ii)		7,22·08	8,13·47	6,97·01	8,65·50	11,59·74	9,17·05

The capital expenditure under the heads given in Group A increased from 20½ lakhs in 1921-22 to about 10 crores of rupees, or on an average, at the rate of 1½ crores of rupees annually. Under the heads included in Group B, it increased from 78 crores in 1921-22 to over 120½ crores in 1927-28. But the mere names of the departments under which new capital heads have been created or the allocation of money under "Reserved" and "Transferred" Departments, gives us absolutely no idea of the actual nature of the expenditure incurred in the different provinces out of borrowed funds on the various schemes of apparently economic development. We shall therefore examine these figures in some detail in order to support the proposition that the expenditure of loan funds has by no means in all cases or in all provinces been wise or judicious. The expenditure involved in such schemes as the construction of Sarda Canal in the United Provinces, the Sutlej Valley Projects in the Punjab and the Lloyd Barrage in Sind, or the promotion of hydro-electric development in Upper India, is indeed very laudable, but when money borrowed at a high rate of interest is spent on wild-cat schemes of a doubtful character, with very little direct or indirect economic benefit

to the community, and involving posterity in disproportionately heavy financial commitments, the attempt being made to pass on to posterity a burden which in any case should really be borne by the taxpayer of to-day, one must of necessity cry halt and ask : whither are we going ? And from any close examination of detailed figures relating to capital expenditure in the different provinces, one is constrained to say that in a number of cases provincial governments have misapplied a part of the loan money which has been raised under the new regime.

We shall now say a word about each of the departments under which capital accounts are maintained in the provinces.

" Agricultural Improvements."—The total amount of money spent out of borrowed funds under this head came to 5·18 lakhs up to the end of 1927-28. The United Provinces spent 4·24 lakhs and Bombay over Rs. 94,000. The whole amount was spent in the " transferred " departments. In the United Provinces, the money has been mostly spent on the extension of the Agricultural College at Cawnpore, and the purchase of land for the extension of the sugarcane farm at Shahjahanpore, and in Bombay

on the acquisition of land for the Agricultural College of Poona. Substantial amounts out of the money have been spent on buildings.

"**Bombay Development Scheme.**"—This scheme was responsible for the expenditure of 11,75·97 lakhs up to 31st March 1928. There has been a great deal of public condemnation of what is called the Back Bay Reclamation Scheme, administered by the Development Department of Bombay, which formed the subject of an investigation by a committee presided over by Sir Grimwood Mears. Without going into many of the allegations made in this connection, it may be stated that a sum of over 3 crores of rupees has been absolutely wasted; and the Finance Member of the Bombay Government in introducing his budget for 1927-28, stated that the provincial revenues of Bombay have been mortgaged for a period of sixty years for the sum of 20 lakhs of rupees a year!

Governor of Bombay[1] which is responsible for the series of deficits which have marred the presidency's financial history and its abolition is foreshadowed in the budget for 1930-31.

"**Civil Works.**"—The total amount of expenditure under the head of Civil Works came to 717·86 lakhs up to the 31st March 1928. This is the biggest head including largely the expenditure on buildings, all the money having been spent on assets of a non-revenue-yielding character. Madras spent 50·91 lakhs, Bombay 341·73 lakhs, Bengal 19·18 lakhs, the United Provinces 184·65 lakhs, and the Punjab 121·37 lakhs of rupees under this head. With the exception of a small sum (a little over five thousand rupees) in Madras, all this money has been spent through the "Transferred" departments. Very heavy expenditure has been made in this way on buildings intended for "Commissioners and District Officers," "Police," "Administration of Justice," on "Jails and Convict Settlements," and "Civil Works," although other sub-heads such as land-revenue, legislative bodies, education, medical, agriculture, industries, communications, etc., also

[1] Address to the Associated Chambers of Commerce, Christmas, 1929.

find a place in the accounts. Bombay has spent moneys under one or more of the former group of sub-heads year after year during the reformed regime. In the United Provinces, considerable sums have been spent on police buildings. Objection to the expenditure of loan funds on police buildings was once raised by the Accountant General (now called Director of Audit) in the United Provinces. It is interesting to observe that a part of the expenditure on police buildings in the year 1925-26 is shown as "reserved" in Bengal, and as "transferred" in Madras, Bombay and the United Provinces. In some provinces, that is, it appears to have been made a matter of accepted financial policy regularly to spend on buildings for various departmental purposes money from borrowed funds.

"**Forests.**"—This head accounts for the expenditure of 56 lakhs of rupees not charged to revenue, the amount being spread as follows:—

Madras ...	12·6	lakhs.
Bombay ...	7·84	"
United Provinces	7·26	"
Punjab ...	·12	"
Central Provinces	23·72	"
Assam ...	4·51	"

Part of the money under this head has been spent on the construction of forest tramways. This is, no doubt, a capital investment. But a perusal of the Finance and Revenue Accounts of the Government of India for the years 1925-26[1] and 1926-27[2] shows that Burma, Bihar and Orissa and Bengal spent considerable sums of money under the sub-heads "communications and buildings," "live-stock," "stores," "tools and plant," "organization, improvement and extension of forests," but found the money out of their revenues. Madras, Bombay, the United Provinces, the Central Provinces and Assam, on the other hand, have used this head as a convenient means of justifying capital expenditure on these very sub-heads.

"Commuted Value of Pensions."—The total amount of money disbursed under this head came to 61·99 lakhs on the 31st March 1928, and was distributed as follows :—

Madras ...	25·49	lakhs.
Bombay . .	6·74	"
Punjab ...	11·15	"
Bihar and Orissa	2·33	"
Central Provinces	12·66	"
Assam ...	3·59	"

[1] P. 106. [2] P. 114.

Bengal, the United Provinces and Burma met their obligations under this head out of current revenues.

"**Hydro-Electric Scheme.**"—Up to the 31st March 1928, 70·23 lakhs had been spent by the Punjab Government on the Uhl River Hydro-electric project in the transferred departments.

This is a project of a very special character which only just recently was the subject of a long and learned article in the *Times.*[1]

Actual work on the spot on this scheme, better known as the Mandi scheme, on which the Mehta Committee has recently reported, was begun in April 1926. According to the article quoted, the supply of current will be available by the autumn of 1932. The total capital cost of a part of the project, which will generate 36,000 kilowatts of energy, will come to 6 crores of rupees instead of $4\frac{1}{4}$ crores originally estimated. But power will be delivered to the local installations at 0·6 pence or still less per unit (the existing cost of production in some towns being $\frac{3}{4}$d. to 2d. per unit) and the scheme will cover

[1] March 22nd, 1930 : "Electric Power in the Punjab."

three-fourths of the Punjab and some western districts of the United Provinces. Finally, it is anticipated that it will yield a satisfactory net income to the State (the Punjab Government), after a few years.

"**Industrial Development.**"—The total amount spent under this head came to 37·55 lakhs, distributed as follows :

Madras ...	...	28·19 lakhs.
Punjab ...	...	7·66 „
United Provinces ...		1·68 „

Expenditure on industrial development rose suddenly from 3·30 lakhs in 1925-26 to 50·16 lakhs in the following year. This sum represents investments in quite a large number of government commercial undertakings, the value of assets being as shown in the books of the various concerns. In the case of the United Provinces, the whole sum represents capital outlay on the Wood Working Institute, Bareilly, which was transferred to this head from Forests in 1926-27.

"**Irrigation.**"—From 1921 to 1928 capital expenditure under this head increased from 71 crores to over 107 crores, or by 36 crores of

rupees. It was by sheer coincidence, however, that a number of important projects in the provinces of Bombay, the United Provinces, the Punjab and Madras, matured for construction immediately after the introduction of the reforms. While provincial governments have shown great capacity and readiness to provide funds under this head for the purpose of creating productive assets, one great difficulty that some of them have encountered is the fact that their big projects have taken, or are still taking, long periods of time to reach the stage at which they become partially or fully remunerative. Work on the Lloyd Barrage for instance was started in 1923, but it is not expected to open the canals of that system for irrigation before 1932. The Sarda Canal was undertaken in 1922, and only a part of the system was opened for irrigation purposes towards the end of 1928. This is a factor which has operated to place a heavy strain on the financial resources of the provincial governments concerned.

"Other Provincial Works."—"Other Provincial Works" account for 69·60 lakhs of rupees. Bombay is responsible for 40·76 lakhs, the United Provinces for 27·23 lakhs, and the Central

Provinces for 1·6 lakh. In Bombay, the expenditure is shown as follows:—

Development of Artillery Maidan, Karachi	20·28 lakhs
Construction of Quarters and Peons' Lines for Excise Department	·19 lakh
Payment of compensation for plant of the Dhulia Distillery ...	2·00 lakhs
Purchase of Sewri Dockyard	·88 lakh
Value of Acetone Factory Buildings at Nasik	17·39 lakhs
Total ...	40·76 lakhs

In the United Provinces, the whole amount represents expenditure on buildings under the heads of land revenue and general administration. Part of the money was spent on grants to Allahabad and Lucknow Universities for the construction of buildings, and to Municipalities and Improvement Trusts for the improvement of water supply. Objection to capital grants to local bodies for such purposes was taken by the Government of India in 1923-24,[1] inasmuch as such expenditure did not, technically, result in the creation of provincial assets. In the Central Provinces the money was spent as capital outlay on the

[1] *Vide* Finance and Revenue Accounts of that year.

purchase of machinery under "Stationery and Printing."

"Improvement of Public Health."—The total amount spent under this head came to 26·85 lakhs. All of it was spent in the "transferred" departments in the Bombay Presidency, and was distributed over the following sub-heads:—

	Rs. (lakhs)
(i) Payment towards the cost of military buildings at Quetta in connection with the scheme for development of Karachi	8·76
(ii) Expenditure in connection with Karad Water Works	·81
(iii) Expenditure in connection with Poona Town-planning scheme ...	·77
(iv) Poona Water Works scheme ...	11·50
(v) Improvement of Distribution system of the Poona Cantonment water supply	5·00
Total ...	26·85

It is interesting to observe that this head was also utilised by Bombay in 1925-26 for the purposes of expenditure on the "construction of an arsenal at Drigh Road, Karachi," and on the "development of the Artillery Maidan at Karachi."

The former sub-head has since disappeared while the latter has been transferred to "Other Provincial Works." In the year 1924-25, the U.P. Government also opened a capital account under this head in order to provide grants-in-aid to Lucknow for the water-works organization scheme, and to Muttra for a sewage scheme, which has since been closed.

Summary of the Position.—We are now in a position to summarise the salient features of capital expenditure in the provinces during the period in which the Montagu-Chelmsford Reforms have been in operation. Put briefly, they are as follows:—

(i) A larger expenditure on irrigation works in a period of seven years, than had been done previously in a whole generation.

(ii) An increasing tendency, particularly in Bombay, U.P., Madras and the Punjab, to use a part of the loan funds for revenue purposes.

(iii) A rather irregular grouping of building accounts under "transferred" departments which should really be classed as "reserved" expenditure.

(iv) An attempt at window-dressing on the part of the provincial governments by seeking to justify expenditure such as that on "military buildings at Quetta," "development of Artillery Maidan at Karachi," or the "construction of an arsenal at Drigh Road," by their inclusion under a popular heading like "Public Health Improvements."

(v) The absence of any particular or uniform system or of any co-ordinated policy as regards block capital grants to local bodies or educational institutions.

How to Put the Debts on a Sound Basis.—We have dealt rather at length with what formed the nucleus of the Provincial Debt, the development of the borrowing powers of the provinces, the uneconomical terms on which their direct loans have been raised, the high rate of interest on which advances from the Government of India have been arranged, the wider scope which capital expenditure in the provinces has assumed, and the great inequality that exists among different provinces as regards existing debts, and requirements for

loan funds. The provincial debt is not very large, nor does it present very complicated problems at this stage. But it is better to nip existing evils in the bud, and to expose now such weaknesses of public borrowing and expenditure in the provincial sphere as need reform. On the 31st March 1928, the gross debt of the London County Council stood at £123·44 million and the revenue for the preceding year came to £29·23 million.[1] On the same date, the gross debt of the eight Provincial Governments (Assam alone had no debt), stood at 142·71 crores of rupees, with revenue at over 90 crores in the preceding year. As for assets, "irrigation capital" alone came to 107·97 crores, and the amount standing to the credit of the Provincial Loan and Advance Account (which must also be regarded as an asset), came to 37 crores of rupees.[2] Having regard to the debt as a whole, the position is satisfactory, although provinces such as Bombay and the United Provinces, which have diverted a part of their capital funds for the creation of other than essentially productive assets, have felt the obstacle

[1] Stock Exchange Year Book, 1929.

[2] Finances and Revenue Accounts of the Government of India for 1927-28, p. 653.

which the dead-weight debt has imposed against possibilities of further expansion of nation-building services. Reforms are needed and can be effected in three directions : (1) The re-adjustment of the debt burden as between the Provinces and the Government of India. (2) The conversion of direct loans to a cheaper rate of interest. (3) The abolition of some of the existing capital heads and provision to ensure their future financing out of revenues.

NEED FOR RE-ADJUSTMENT OF BURDEN WITH THE GOVERNMENT OF INDIA

(i) **Reduction of Provincial Debt.**—We have already adduced in a previous paragraph a number of arguments for writing off 8·88 crores of Provincial Debt which was supposed to be the amount due from the provinces to the Government of India in connection with the Provincial Loan Account. Similar considerations and others that will be presently mentioned, warrant a readjustment of what is called the pre-reform provincial irrigation debt. Put briefly, our reasons for this course are as follows :—

In the first place, some of the canals over which that money was spent were built one, two

or three generations ago. The Ganges Canal, for instance, was built in the middle of the last century. It is equitable, therefore, to write down the original cost in such cases when the assets are transferred into the hands of new States. This is the more necessary as considerable sums of money are annually spent on the upkeep of irrigation assets by the provinces. Secondly, in the pre-reform era when all revenues vested in the Government of India, considerable amounts of money were spent out of the budget surpluses on the reduction or avoidance of public debt, productive as well as unproductive. It was the frequent resort to that practice on the part of the Government of India that enabled them to reduce their "ordinary" or "unproductive" debt from 105 crores in 1898 to 3 crores of rupees in 1916. And finally, considerable amounts of money were also spent by the Government of India out of revenues on the construction of provincial irrigation works. "A sum of Rs. 17,12,18,089 in all was, prior to 1920-21, expended from the revenues of the Central Government upon the construction of irrigation works in the provinces." "When the reformed constitution was introduced in 1920-21, Devolution Rule 24 provided that all sums so

expended should be treated as advances made by the Central Government to the Provincial Governments. From the point of view of the latter, therefore, the works were constructed, not out of revenue, but out of borrowed funds."[1] The presumption is, that there must have been some faults in the productive character of those works that they were financed out of revenue, and not out of loan funds. When debts and assets have been separated, it is only fair that the advantages of the expenditure of revenue funds on the irrigation assets, or the reduction of debt in the past should not remain confined to the Government of India alone, but also be shared by the provinces in the shape of a reduction in the valuation of their transferred assets. The Government of India are the more in a position to take over a part of this burden as their sterling debt in the form of its rupee equivalent has decreased by $12\frac{1}{2}$ per cent as a result of the increase in the exchange ratio from 1s. 4d. per rupee before the war to 1s. 6d. per rupee in the recent years. It may be of interest to mention in this connection that at the time of the Canadian Confederation in the sixties of the last century,

[1] Finance and Revenue Accounts of the Government of India, 1927-28, p. 185.

it was agreed by Resolution 60 of the Quebeck Conference in regard to the debt "that the Central Government should assume all the debts and liabilities of each province."[1]

(ii) **Institution of a Joint Sinking Fund.**—Another way to readjust financial relations with the Central Government is to institute a Joint Sinking Fund for the redemption of the Provincial Debt, particularly the pre-reform portion thereof, to which the Central Government should be required to contribute on a 50 per cent basis. Somehow or other, there is a feeling abroad in India, particularly in official circles, to regard the financial requirements of provincial governments as something less important than those of the Central Government. Quite the reverse is the case in some other Federal Constitutions. "A comparatively new feature in the Dominion-provincial relations," says Boos with regard to the position in Canada, "has recently been developing in the form of Federal subventions and aids to the provinces for specific purposes, such as technical education, highway construction, health promoting activities, unemployment relief and old age

[1] "The Financial Arrangements between the Provinces and the Dominion" by A.W. Boos, p. 4.

pensions."[1] In the Commonwealth of Australia, according to the recent loan agreement as regards the coordination of State and Federal borrowings by the Australian Loan Council, it has been laid down that the Federal Government will contribute $\frac{1}{8}$ per cent annually towards the Sinking Fund on the old State debts taken over by the Federal Government, and $\frac{1}{4}$ per cent annually towards the Sinking Fund created for the redemption of new State loans.[2] The institution of a Joint Sinking Fund of this character would appear to be very desirable in India before the provinces hypothecate their revenues too heavily in connection with the debt obligations. Excluding the direct loan of 9·38 crores, raised by the province of Bombay in 1920-21, the pre-reform provincial debt, as shown on page 116, stood at 71·49 crores of rupees. One-half of a fixed annual contribution for the amortisation of this amount in a period of 80 years will not involve the Central Government in an annual liability of more than a few lakhs of rupees. But the step will lighten the provincial burden and provide for the automatic redemption of a considerable portion of the provincial debt in a fixed number of years.

[1] Ibid., p. 84.

[2] *Economist*, July 30th, 1927.

(iii) **Consolidation of Advances.**—There is yet a third way in which the Central Government can give relief to the provinces. We have shown elsewhere that on the basis of the actual payment made, the rates of interest on the fresh advances from the Central Government have worked out at very high figures since the inception of the reforms. That the resources of the provincial governments are very meagre and inelastic is recognised on all hands. The provinces cannot afford to use loan funds borrowed at a high rate of interest. In some other Dominions, the Central Government helps the constituent parts as regards the debt obligations in one way or the other. According to Section 9 of Act 10 of 1913, the provinces in the Union of South Africa are not permitted to borrow from any source other than the Union Treasury. The whole sub-section of the Act runs as follows: "The moneys which may from time to time be required by any province for the purpose of meeting any capital or non-recurrent expenditure (as defined in Section 6) shall be advanced to that province upon loan as required in such amounts as Parliament by annual appropriation may authorise. Any such advance shall bear interest at a rate not exceeding 5 per cent per

annum from the date of issue and shall be repaid by the province to the Treasury by equal half-yearly instalments so calculated that the whole advance and the interest thereon will be repaid within such period not being less than 15 years and not exceeding 40 years reckoned from the first day of July or the first day of January next succeeding the date of issue as the Treasury may determine, regard being had to the nature of the work for which such advance is to be made." Thus, the maximum as regards the rate of interest at which advances are made by the Central Government to provincial administrations is fixed in South Africa. "As regards the loans to the Land Bank, the provinces and local bodies," writes Mr. de Cock,[1] "it may be said that they are generally reproductive, but a small loss is incurred by the Treasury mainly in respect of the cost of raising these loans, as such cost has not been charged to the respective institutions in most cases." It is very interesting to observe that advances to the Land Bank were made at a lower rate of interest than that at which Treasury had to borrow. This is the position in the Union of South Africa. There

[1] "Finances of the Union of South Africa," p. 307 (1927 edition).

would therefore appear to be a strong case in India for the consolidation of all the post-reform advances from the Central Government to the provincial governments at a low rate of interest. If all the advances made since March 1921 (which amounted to over 60 crores of rupees in 1928), are so consolidated at 5 per cent rate of interest, the step will mean a relief to the provinces of at least as many lakhs of rupees (about 60 lakhs).

Conversion of Direct Loans.—Another way to reduce the burden of the existing provincial debt is to arrange the conversion of direct loans to a smaller rate of interest. In spite of a sharp upward trend in the money rate in India since 1927, the existing rate of 5 per cent on Government loans is cheaper than the rates which the provincial governments' direct loans carry.[1] The United Provinces Government 6 per cent 4·19 crores loan is repayable in 1931 at the earliest, the Punjab Government $6\frac{1}{4}$ per cent 1·9 crore loan in 1933, the Bombay Government $6\frac{1}{2}$ per cent 9·38 crores loan in 1935 and the Punjab Government $5\frac{3}{4}$ per cent 12-year Bonds of 88 lakhs in 1937. If all these are converted either by fresh borrowing

[1] The rate on rupee loan in 1930 has gone up to 6%

or through advances from the Government of India at 5 per cent rate of interest, there will be a net saving of at least 21 lakhs of rupees in the provincial interest charges.

Spending of Loans on Unproductive Heads Should Stop.—But no readjustment of financial relations with the Central Government or reforms in the sphere of provincial borrowings will be of much avail unless they are accompanied by a simultaneous reform in the sphere of provincial capital expenditure. It is necessary that some at least of the existing new heads under which capital accounts have been started in the new regime under the stress of financial stringency should close. The transfer of the provincial debt to the extent of 26 crores of rupees to the Government of India (8·88 crores due to the Provincial Loan Account as it stood in 1921, and 17·12 crores due to the pre-reform irrigation assets built out of revenue funds), consolidation of the post-reform advances at a low rate of interest, the provision for the amortisation of the pre-reform irrigation debt by the institution of a joint sinking fund, and the conversion of direct loans to a cheaper rate of interest—all these steps will result in a saving to the provinces in their

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interest bill, amounting roughly to over $1\frac{1}{2}$ crore of rupees annually. We have shown on page 139 that this amount, in fact, is the average of the deficit in the provincial revenues for the seven years 1921-28 on account of expenditure on certain capital heads (Group A) which has so far been met out of the loan funds. With the savings thus effected, those items can be made a proper charge on the revenues in future.

Post-Reform Financial Difficulties of Provinces.—Let us, however, frankly recognise the exceptional financial difficulties owing to which the new semi-popular provincial governments have been handicapped during the working of the reforms. Dissipation of the accumulated balances and hypothecation of accrued increased provincial revenues on the eve of the introduction of the reforms, high public expectation for increased expenditure on popular departments, unexpanding revenues, reluctance of new legislatures to impose additional taxation, levy of provincial contributions for a number of years, delay in the working of some provincial productive capital works (also miscarriage in the case of some others), budget deficits—these were some of the more important features of the provincial finances

during the period under consideration.[1] "During the war," said Sir (then Mr.) Malcolm Hailey,[2] "we were obliged to ask the provinces not to draw on their balances and to keep their expenditure strictly within the income of the year. This restriction was relaxed for the current year, and the provinces were allowed to budget for deficit aggregating nearly 3 crores, although as I have already mentioned, their revenues have on the whole actually been equal to their expenditure. For next year, although budgeting for revenues materially larger than those of the present year, they anticipate drawing on their balances to the extent of no less than $5\frac{3}{4}$ crores of rupees. A great part of these deficits is accounted for by large schemes of non-recurring expenditure which were necessarily held up during the war, but there is also a striking increase in the budgeted recurring expenditure, due to the very large revisions of the pay of subordinate establishments necessitated by the present scale of prices." Referring to the increase of 11 crores to be enjoyed by the provinces under the new reforms,

[1] Most of these conclusions have since been borne out by Sir W. T. Layton's Report, published as part of the Simon Commission Report.

[2] Para 41 of Budget Speech for 1920-21.

the Finance Member of the Government of India said,[1] "I do not wish to draw a picture of the provincial governments luxuriating in newly-found riches, the extra revenues which they are about to receive have been, in the case of most provinces to a large extent already hypothecated in the financing of the wholesale revisions of pay of all establishments and particularly subordinate establishments, which have been sanctioned during the past two years. My point is that, but for the new financial arrangements, those increases of pay could not have been financed at all . . ." "It was a commonplace," said Sir Malcolm in a later paragraph of the same speech, "that the heads of revenue retained by the Central Government were mainly, not only heads of growing revenue, but also those in respect of which there was undoubtedly a substantial margin for increased taxation, which was much less the case with the heads of revenue given over to the provinces." Referring to provincial finances, Sir Basil Blackett stated[2]: "Meanwhile every provincial government without exception is finding very great difficulty in balancing its budget. The majority, I am afraid, did

[1] Budget Speech for 1921-22. [2] Budget Speech, 1923.

not succeed in doing so in 1922-23, though they are doing better I am glad to see for 1923-24." As regards the provincial contributions, Sir Basil said,[1] "Ever since the Reforms were inaugurated, the provincial contributions have been a mill-stone round the neck both of the Central Government and of the Provincial Governments, poisoning their mutual relations and hampering their every action. Their quality even more than their amount, has strained the resources of the giver and the patience of the recipient. They have brought curses, not blessings, both to him who has given and to him who has taken. The year 1927-28 sets India free from all this incubus."

It will thus appear from what we have stated that in an era of acute financial stringency, more particularly in the beginning than towards the end of the post-reform period, the provinces were led to adopt financial devices of a doubtful character with a view to making ends meet. According to the Simon Commission Report,[2] "so far from there being any marked development of the 'nation-building' services entrusted to ministers, expenditure on the transferred

[1] Budget Speech, 1927-28. [2] Vol. I, p. 353.

departments at the end of 1923-24 was actually less than in the year 1921-22." In fact, most of the new capital heads were started in the first few years under the reforms, when it was a period of deficit budgets. But there is no gainsaying the fact that some provinces have now made it a matter of regular practice to utilize loan funds for purposes for which money in the pre-reform period was found out of revenues and is still so found by some other provinces. It is not a question of how wide powers the provinces enjoy to spend loan funds, but a question of taking a long view of the future condition of provincial finances, how far they will be able to stand any burden of future debt charges. "In a country in which the taxable capacity of people is limited and the needs, that are clamouring for satisfaction, numerous," says Mr. Gyanchand,[1] "every expenditure from loans is likely to appear in the light of investment which promises rich return in the near future. If the money for education, public health and various demands of national life is found out of borrowed funds, it will not strain the resources of the tax-payer and give us services which are admitted to be necessary

[1] "Financial System of India," pp. 308-09.

and beneficial. But if it becomes part of our accepted policy to defray the expenses of such activities from public loans, the door is opened for the use of devices which have everywhere led to financial disorganization." In the light of these observations, a great deal of the almost recurring annual capital expenditure on items shown in Group A on page 138 would require a stronger justification than the mere excuse of financial stringency for its continuance in that form. In spite of what Mr. Findlay Shirras may say,[1] in order to bless capital expenditure on police buildings under certain circumstances, we hold the view that capital expenditure on non-revenue-yielding assets is justifiable in the existing inelastic state of provincial finances only when such expenditure leads, sooner or in the long run, to the economic and material welfare and prosperity of the population and not for the promotion of general departmental efficiency of the administration.

Expenditure on many sub-heads under "Civil Works" does not satisfy this acid test. There would, therefore, appear to be the necessity of the closest scrutiny to separate

[1] "Science of Public Finance," p. 96.

the wheat from the chaff, re-classify the capital expenditure of 9·75 crores under all those seven new capital heads, and meet most of the future demands under them out of revenues. It is much better to face facts and know the budget deficit than merely to circumvent the difficulties by meeting part of the revenue expenditure out of loan funds. The latter in the long run proves a step in the direction of false economy.

This is by no means to suggest that we should revert to the pre-reform practice of capital expenditure on reproductive assests only. Some part of the capital expenditure of the future is bound to be incurred on assets that may not yield revenue. We would indeed recommend the undertaking of works of public utility, such as the improvement of water supply, sewage works, housing in industrial areas, road-building and bridge construction, schemes of educational expansion, etc., but on a well-defined basis, so that other bodies interested might share a part of the interest and sinking fund charges.

Direct capital expenditure by the state, moreover, is not the only way in which public credit can be used for the development of provincial resources. Each provincial government maintains what is known as a "Provincial Loan and

Advance Account," out of which loans and advances are granted to local bodies and many other institutions and individuals. The degree to which the usefulness of borrowed funds raised by the provinces can be further extended in an indirect fashion is well illustrated by the following passage taken from the Madras Administration Report for 1926-27:—

"The Provincial Advance and Loan Account including loans to local boards for railway construction), opened with a balance of 335·64 lakhs and closed with a balance of 382·94 lakhs. Advances to cultivators sanctioned in 1926-27 amounted to 26·83 lakhs as against 28·53 lakhs in the previous year. A loan of 29 lakhs of rupees was sanctioned under the State Aid to Industries Act. Loans were also granted to the Madras Corporation (4 lakhs), the Cochin Port Conservancy Board (4·5 lakhs), and the Tuticorin Port Trust (6 lakhs). The loans granted to Mofussil Municipalities and Local Boards for the construction of bridges, drainge works, markets and hospitals and similar works amounted to 29·96 lakhs. Advances amounting to 1·83 lakhs were granted to the Board of Commissioners under the Hindu Religious Endowment Act. Advances for the purpose

of the house sites for Adi-Dravidas amounted to 7·08 lakhs (the sum includes 4·71 lakhs advanced to Co-operative Societies for this purpose). Loans to House-building Co-operative Societies and Kallar Co-operative Societies amounting to 3·63 lakhs and 1·79 lakhs respectively were also disbursed during the year. Loans were also sanctioned to Co-operative Sale Societies (·06 lakh) and Land Mortgage Bank (42 lakhs)."

The same report further states that a loan of 2 crores of rupees from the Central Government was secured at 5 per cent rate of interest; that an amount of 33 lakhs of rupees was repaid to the same Government owing to previous advances and the annual instalment of outstanding balance of the Provincial Loan Account; and that a deserving application of the Carnatic Mills for a loan of a couple of lakhs of rupees was postponed for the next year. As pointed out on page 152, the assets represented by this Account in all the provinces now amount to 37 crores of rupees as against 9 crores in 1921 when it was taken over by the provinces from the Government of India.

Future Machinery for Financing the Provinces.—Before we conclude this discussion of the Provincial Debts, there remains one very

important question in connection therewith, namely, the question of the future machinery for the purpose of financing the provincial governments in India. For this we think a new institution is needed. We defer to the last chapter the consideration of the lines on which we propose its constitution should be drawn, and as to what should be the functions of that body and the scope of its activities; we shall discuss here the desirability of having such an institution for that purpose. In view of the reduced rates of interest charged by the Government of India to the Provincial Loans Fund in recent years, is there at all a case for the creation of new and separate machinery to finance the capital requirements of the provincial governments?

Under the existing financial arrangements, the Government of India is the custodian of all cash balances, central and provincial, loan or revenue, large or small, fixed or current, general or earmarked, whether available for a short term or for a long period. In controlling these balances and in granting advances to the provinces, the Government of India plays a role akin to that of a private banker. Its terms also are similar—no interest is allowed on very small or current balances, low interest on short-term balances, a

moderate rate on long-term deposits,[1] a high rate is charged on overdrafts, and no accommodation is granted when inconvenient to the Government. Even the Simon Commission has objected to the attempt on the part of the Government of India "to make undue profits out of the business for the benefit of the central budget."[2]

Let us here state clearly that the question of provincial control over their own balances, and the means for their day-to-day finance, is altogether different from the question of providing finance for the capital progammes of the provincial governments. So far as the effect of the separation of provincial balances from the general balances of the Government of India is concerned, Mr. J. E. C. Jukes submitted in his memorandum to the Reforms Enquiry Committee that "the sums involved will in every case be more than sufficient to place the provinces in funds to meet their day-to-day requirements."[3]

[1] See also pp. 210-11. [2] Vol. II, p. 266.

[3] According to Statement XXIII, given on pp. 74-75 of the Report of the Controller of Currency for 1929-30, the interest-bearing balances of the provincial governments with the Government of India amounted on the 31st March of each year to :

Rs. 2·86 crores in 1923	Rs. 10·49 crores in 1927
Rs. 4·17 " " 1924	Rs. 10·48 " " 1928
Rs. 4·83 " " 1925	Rs. 10·43 " " 1929
Rs. 11·87 " " 1926	Rs. 10·17 " " 1930

Coupled with the suggestion of Dr. Banerjea to empower the provinces to obtain short-term Ways and Means advances from the Imperial Bank of India,[1] the proposal to release provincial balances will, if realized, considerably reduce the necessity of the many small advances now annually required by the provinces from the Government of India.[2]

This, however, does not solve the problem of providing the large capital funds needed to raise large works of a permanent character. The mechanism of direct loans obtained separately by each province, is very expensive in the aggregate, particularly in view of the very small amounts that each province requires at any one time. Far be it from us to suggest anything in the nature of restrictions on the financial powers of the provinces as regards borrowing in the open money market. The experience gained so far is too meagre to warrant any conclusion of that sort. The period we have dealt with has been only the beginning. The provinces have had to insure the success of their issues and to build up their credit as borrowing authorities. But in view of the comparatively high price

[1] P. Banerjea : "Provincial Finance in India," p. 50.

[2] See p. 122.

at which loan money is obtained by the provinces, either by means of direct loans or through advances from the Central Government—the former being distinctly more expensive than the latter—there would appear to be a necessity for devising some simpler methods for the provinces in order to enable them to raise the capital funds necessary for their requirements. Any future scheme for the purpose must take due account of two important factors, viz., (i) it should tend to mobilize the provincial monetary resources, and (ii) it should make cheap funds available to the provinces at least during the construction period of major productive works which take a very long time for their completion.

Separation of Borrowing Resources Suggested.—When the Provincial Loan Fund was created by the Government of India in 1925-26, it was provided that "in future, loans to Provincial Governments will be made from the Provincial Loans Fund, a standard rate of interest being charged for all such loans, except those not required for capital expenditure classed as productive, the rate for which will be one-quarter per cent above the standard rate."[1] In view

[1] Report of the Controller of Currency for 1924-25, para. 25.

of the fact that large amounts of money are locked up in big irrigation works until the time they begin to yield revenue, we believe the case is exactly the other way. Therefore, we suggest that, following the precedent of the separation of the sources of revenue between the Central and the Provincial Governments, and the further proposal to separate the balances, we should also separate the provincial borrowing resources from those of the Government of India, and definitely allocate to the former the proceeds of what are called the "other obligations" of the Government, including Post Office Savings Banks, Cash Certificates and Provident Funds, etc.

It is very interesting in this connection to note that the total investment under this head stood at 62·50 crores in March, 1923, and at 127·46 crores in March 1929, thus yielding on an average 10 crores of rupees annually. This is exactly the sum that the provinces annually require on an average for their capital expenditure.

The scheme here proposed would attain the two objects in view, mentioned above, besides considerably stimulating provincial patriotism. It may also incidentally be mentioned here that

for some years the practice was followed in England of granting to local bodies loans to the extent of half the proceeds of the National Savings Certificates raised in that area. "What a great improvement in our financial outlook will result," said Sir Basil Blackett in 1923,[1] "if by development of the Post Office Cash Certificate System, a considerable part, if not the whole, of the money required for provincial capital expenditure could be found out of the proceeds of Cash Certificates." Our suggestion would provide ready-made resources for the provincial governments — resources, moreover, of which a considerable part is already well distributed in different provinces more or less in accordance with their needs.

[1] Financial Statement, 1923, para 22.

STATEMENT SHOWING THE TERMS OF PROVINCIAL LOANS

Name of province	Date of issue	Amount of issue Rs.	Price of issue	Rate of interest	Whether tax-free or not	Date of interest payment	First date of redemption	Final date of redemption	Terms of depreciation or redemption fund if any
Bombay	Sept. 1920	9,38,93,300	par	6½%	Free of income-tax but not super-tax	May 1 and Nov. 1	Nov. 1, 1935	Nov. 1, 1935	Dep. F. at 1% p. a. applicable to purchases at or below par.
U. P.	Nov. 1921	4,19,47,800	93	6%	Free of income-tax but not super-tax	May 15 and Nov. 15	Nov. 15, 1931	Nov. 15, 1941	Rs. 3,00,000 p. a. for 5 years ending 1926 and 1/15th of loan p. a. thereafter.[1]
Punjab[2]	1923	1,90,12,800 issued in Bonds	par	6¼%		April 16 and Oct. 16	Oct. 16, 1933	Oct. 16, 1933	
Punjab	1925	88,11,300 12-year Bonds[3]	par	5¾%			Oct. 16, 1937	Oct. 16, 1937	S. Fund provided.

[1] A certain sum not exceeding the amount at credit of S. Fund less Rs. 5,00,000 is to be set aside annually after November 15th, 1926, for redemption at par at bond-holders' option.

[2] For canal projects.

[3] Acceptable at par in payment for Crown lands irrigated from Sutlej Valley Canal.

CHAPTER IV

DEBT REDEMPTION

Necessity for Debt Redemption.—The contraction of public debt necessarily raises the question of methods and measures for its redemption. Ordinarily, an investment debt like that of India need hardly ever be repaid. But the necessity for taking proper steps to secure the repayment of public debt arises mainly for two reasons. In the first place, the presence of a large dead-weight debt is a very real burden; it imposes a heavy strain on the population, and on account of the necessity of providing for debt charges, leaves less revenue for expenditure on other national services. Secondly, if a government has an extensive programme of fresh borrowing and reborrowing, some provision for the redemption of debt becomes absolutely necessary if it is to be

able to borrow and re-borrow at fair and equitable rates of interest. Both these factors have been in evidence in India in the post-war period.

India's Insignificant Unproductive Debt at the Outbreak of War.—According to "The Guide Book for Investors in Government of India Securities",[1] ordinary or non-commercial debt stood at 105 crores in 1898, and gradually fell to 3·3 crores by 1915, and to 3 crores of rupees in the following year. Thus we started the war with almost a clean slate so far as the unproductive debt was concerned. On account, however, of capital expenditure on the construction of New Delhi to the extent of about 13 crores of rupees, India's war contribution to Britain of a hundred million pounds, and budget deficits in the post-war years amounting roughly to 100 crores of rupees, the debt liabilities of the Government of India in other forms than commercial and recoverable assets, swelled to high proportions in the post-war period. This is borne out by the subjoined table, which shows the amount of unproductive debt of the Central Government in post-war years:

[1] 1921 Edition, p. 2.

OUTSTANDING UNPRODUCTIVE DEBT OF THE CENTRAL GOVERNMENT [1]

(In crores of rupees)

Date	Amount of debt	Converted at 1s. 6d.
31st March 1918	194·07	154·58
1922	261·47	227·28
1923	203·90	
1924	204·95	
1925	196·03	
1926	194·58	
1927	181·81	
1928	172·66	
1929	170·61	
1930	176·48	

The above represents the position as regards the unproductive debt. So far as borrowing is concerned, we find that during and since the war, India has been raising money largely on a short-term basis. Whereas, before the war, almost

[1] In the above table, the figures for 1918 and 1922 are taken from page 26 of the Report of the Controller of Currency for 1924-25, and are based on the conversion of sterling debt at the rate of 1s. 4d. to the rupee and not at the rate of 1s. 6d. which is the basis of conversion in the case of all other figures set forth above. For the sake of a proper comparison, we have set out the corresponding figures for 1918 and 1922 at the rate of 1s. 6d. in a parallel column. The figures since 1923 have been taken from Table XXIII, pp. 74-75 of the Report of Controller of Currency for 1929-30.

the whole of the permanent debt of the Government of India, rupee as well as sterling, amounting on the 31st March 1914 to 145·63 crores of rupees and £177·06 million respectively was owed in the form of non-terminable loans, indefinitely redeemable at the Government's option (except the remainder of a short sterling loan of £4 million raised in 1911, which was repayable in eight equal annual instalments), in the post-war period, year after year, as the following table will show, conversions of maturing obligations have formed a heavy proportion of the rupee loans annually raised in India:—

RUPEE LOANS 1920—30 [1]

(*In crores of rupees*)

Year		Total loan raised	Converted portion thereof	Net amount raised
1920-21	...	29·75	17·92	11·83
1921-22	...	49·20	10·57	38·63
1922-23	...	46·86	3·21	43·65
1923-24	...	23·97	·08	23·89
1924-25	...	13·21	·23	12·98
1925-26	...	30·61	30·61	...
1926-27	...	29·28	12·74	16·54
1927-28	...	19·53	11·32	8·21
1928-29	...	35·03	11·12	23·91
1929-30	...	36·86	23·24	13·62
Total	...	314·30	121·04	193·26

[1] Compiled from the Annual Explanatory Memoranda of the Secretary or Under-Secretary of State for India.

In the last decade, the Government of India has been continually faced with early maturities coming up for payment. The prospect for the future is not so very different from the position in the past. This will be seen from the following two tables which set out the maturities of the various rupee and sterling loans of the Government of India for the next few years :—

STATEMENT SHOWING THE MATURITIES OF LOANS AS AT THE 31ST DECEMBER, 1929 [1]

(a) *Rupee loans* (*In crores of rupees*)

6% Ten-year Bonds	1930	15·77
6% Ten " "	1931	7·36
6% Ten " "	1932	14·63
5% Ten " "	1933	21·45
4½% Rupee Bonds	1934	25·98
5% Ten-year Bonds... ...	1935	12·83
4% Conversion Loan ...	1931-36	9·90
4% Rupee Loan	1934-37	19·53
5% " " (raised in 1929)	1939-44	29·14
5% War Loan	1929-47	22·19
5% Income-tax-free Loan ...	1945-55	59·27
4½% Rupee Loan	1955-60	9·05
4% " "	1960-70	29·49
Total terminable loans		276·63
Total non-terminable loans and three Railway loans from Native States		128·50
		405·13

[1] From the Gazette of India, March 15th, 1930, Pt. II, p. 392.

(b) *Sterling loans* (*In £ millions*) [1]

6% Bonds ...	... 1932-33	6·00
5½% India Stock ...	... 1932	20·42
4½% " " ...	... 1950-55	39·85
4½% " " ...	... 1958-68	17·50
Total terminable loans ...	...	83·77
Total non-terminable loans ...	...	177·21
Other debts such as Railway loans, annuities, and the War Contribution and Provident Funds, etc. ...	...	97·52
		358·50

What do we find from the above tables? In the next seven years, the Government of India has to re-borrow 127·45 crores of rupees in India, and £26·42 million (or 34·67 crores of rupees) in England. In addition, the Government has options for railway purchases of no less than £16·54 million (22·04 crores of rupees), falling due in the same period,[2] and to these must be added also

[1] The figures regarding sterling terminable loans have been taken from the Parliamentary Return on the Public Debt of India (October 1929). The amount of £6 million 1932-33 Bonds, issued in February 1930, has been replaced for India Bills. The remaining figures are based on the information given on page 52 of the Report of Controller of Currency for 1928-29. For a statement of the total Indian Public Debt as it stood on the 31st March 1930, please refer to table on page 13.

[2] For details, see *Economist*, February 22nd, 1930.

another 16·35 crores of rupees due to the following separate direct provincial loans repayable in the same period:

		Rs. crores
6 per cent United Provinces Development Loan ...	1931-41	4·19
$6\frac{1}{4}$ per cent Punjab Bonds ...	1933	1·90
$6\frac{1}{2}$ per cent Bombay Development Loan	1935	9·38
$5\frac{3}{4}$ per cent Punjab Bonds ...	1937	·88
Total ...		16·35

It will thus appear that the Central Government and the provinces have to re-finance a programme of exactly 200 crores of rupees in the next seven years.[1] A fairly big section of these early maturities of the Central Government and all the loans of the provinces carry a rate of interest of more than 5 per cent. The problem of converting these high-interest-bearing early maturities into long-term debt at a fair and reasonable rate of interest is likely to be complicated in the future, as in the past, by the necessity of raising fresh loans for important capital requirements. There would therefore appear to be abundant justification for the consideration of the

[1] Over and above these early maturing obligations, the amounts of the May 1930 sterling issue and a section of the August 1930 rupee loan are also repayable within the next few years.

problem of debt redemption or conversion as it has faced India in the post-bellum period.

Former Provision for Debt Redemption.— Formerly the provision for debt redemption in India was made in three ways:

(i) By means of railway annuities and sinking funds, a small portion of the capital invested in the State railways was repaid out of the railway earnings. Sinking funds were attached to railway annuities compulsorily by Acts of Parliament, and will last up to 1946-47.[1]

(ii) A certain amount, usually half-a-million sterling, out of the annual famine insurance grant of £1 million was used for the reduction or avoidance of debt.

(iii) Budget surpluses of the Government of India, which were so recurrent a feature of the pre-war years, were employed to write down the unproductive portion of the Indian public debt.

We have already pointed out that the cumulative effect of all these operations was, that the unproductive debt stood at the nominal sum of only three crores of rupees in 1916.

[1] Statement of Mr. McWaters, Financial Secretary, in the Council of State, September 11th, 1924.

Reduction of the debt out of revenue surpluses in the pre-war years was largely accidental, and not deliberate or part of a formulated policy. The war was followed by a period of recurrent deficits. More recently, the practice of carrying any small revenue surplus to a suspense account for expenditure in lean years has been adopted. So budget surpluses of any magnitude could not be looked to to wipe off the unproductive debt. It may be noted, at the same time, that the idea of relying on budget surpluses as an effective means for the reduction of debt has been abandoned in recent times in some other countries, notably Great Britain, in favour of a fixed minimum annual contribution out of revenues.

The Famine Insurance Fund and its future financing became a provincial affair on the introduction of the Reforms in 1921, and so this source was also lost so far as its employment for debt redemption was concerned. After 1924-25, general revenues began to bear the charges borne till then by railway revenues on account of railway sinking funds, and the capital portion of the annuities in purchase of railways.[1]

[1] Financial Secretary's Budget Memorandum, 1924, para 43.

In addition to the above modifications in the provision for reduction or avoidance of debt, some other developments had taken place in the meantime. In the case of certain loans (1917 and 1919 five per cents, and the subsequent issues of the latter), $1\frac{1}{2}$ per cent special Depreciation Funds were attached in order to buy the securities in case their market prices fell below the price of their issue. The prices of these securities still touched points as low as 77 per cent and $78\frac{1}{2}$ per cent in 1920-21, although their original issue price was 95, and it became a matter of supreme concern and anxiety to the Government that their recently-issued loan paper should be so badly depreciated in the market. Some artificial propping was needed to undo the evil, and was supplied by the provision which took effect from 1921-22, of an additional amount of 80 lakhs of rupees annually, besides the usual depreciation fund amount, in order to buy and cancel these securities. As the prices of these two 5 per cent long-term loans showed an appreciable improvement in the subsequent years, this special provision of 80 lakhs of rupees had to be used for the intended purpose in 1921-22 only, and not in subsequent years.

The remainder of the liability, finally, in connection with the war contribution, was arranged to be repaid out of revenues by a system of annual equated instalments spread over a period up to 1947, the amount paid every year including repayment of the principal and interest.

Sir Basil Blackett's New Scheme.—This was the position in 1924, when, following the example set in Great Britain in 1923 by Mr. Baldwin, then Chancellor of the Exchequer, Sir Basil Blackett, Finance Member of the Government of India, adumbrated in the Financial Statement of 1924 his scheme for co-ordinating and systematizing all provisions for debt redemption into one general sinking fund, intended for the reduction or avoidance of public debt in India. The main features of the scheme, which ultimately formed the basis of a Government Resolution,[1] and which came into operation with effect from 1925-26 for a period of five years, are fully discussed in paragraphs 28 to 38 of the Statement referred to above. As it is this scheme which we propose to put to a critical examination, and to which we suggest some modifications, we will recapitulate here its principal points :

[1] No. F-13-11-F of December 9th, 1924.

Sir Basil Blackett put the total debt on the 31st March 1924 at approximately 917·53 crores of rupees. After making allowance for 98·81 crores of rupees due from the Provincial Governments and for 11·88 crores of rupees representing discount on past loans, he arrived at the figure of 806·84 crores of rupees for the amortization of which sinking fund provision was needed. He suggested the following terms for the redemption of the different classes of debt:—

Kind of debt	Amount due in crores on 31st March 1924	Period of redemption
Productive debt, e.g., railways	578·39	80 years
War debt	120·60	50 "
Deficits of five years (1918-23)	98·00	25 "
Building of New Delhi ...	9·85	15 "
Total ...	806·84	

"If we take the periods named," said Sir Basil, "and apply them to the different classes of debt mentioned, and assume further that any sums provided year by year were set aside to accumulate at 5 per cent compound interest,

we obtain as our result a figure of 3·66 crores as the amount which it would be necessary on the above basis to provide annually, beginning with the year 1924-25, to redeem the whole debt within the periods named. But it would not be convenient or desirable to set this sum aside year by year to accumulate at compound interest in the manner assumed in the calculation. It must be expended in the year in which it is provided, either on actual repayment of existing debt, or for new capital purposes, in order to reduce the amount of our new borrowings. By so using it, we reduce the amount we have to pay in interest in the future. We could, indeed, obtain a result equivalent to accumulation at compound interest if we first of all provided 3·66 crores in 1924-25 and then set aside in 1925-26, in addition, a sum equivalent to 5 per cent interest on 3·66 crores, and so on in future years. In that case, the sums actually required during the next five years would be :—

(*In crores of rupees*)

1924-25	1925-26	1926-27	1927-28	1928-29
3·66	3·84	4·04	4·24	4·45

This would, however, be rather a cumbrous arrangement, and in view of the hypothetical

nature of some of the data on which the calculation is based, for example, the assumption of a rate of exactly 5 per cent for the interest, it would be better to achieve the results desired by some more simple process. The same amount of debt would be redeemed if a provision of 4·04 crores were made in each year for the next five years. We may, therefore, conclude that a figure of 4 crores per annum would be an adequate provision to include in our budget expenditure for the next five years for dealing with our existing debt."

So far as future additions to the debt were concerned, an annual increment of $\frac{1}{80}$th of the net addition to the debt each year was suggested on the assumption that all future borrowings were to be made strictly for productive purposes. The scheme, as outlined above, was sanctioned by the Secretary of State for India, and finally embodied in a Resolution which was issued together with a memorandum. The principal clauses were as follows :—

1. "This scheme shall be in force for the five years 1925-26 and 1929-30 inclusive.

2. There shall be charged against the revenues of India in each year during which this scheme is in force for the purpose of making

provision for the reduction or avoidance of debt:

(a) a sum of 4 crores, and

(b) such additional sum as is equal to one-eightieth of any excess shown in the total of the debt outstanding on the 31st of March of the preceding year over the total outstanding on the 31st March 1923.

3. The Governor-General-in-Council shall apply the debt charge prescribed above towards meeting:

(a) the railway sinking fund now in operation;

(b) the depreciation funds of $1\frac{1}{2}$ per cent on the 5 per cent loans;

(c) the capital portion of railway annuities; and

(d) the capital portion of the annual payment in redemption of India's outstanding liability in respect of the British War Loan, and the balance, if any, towards the avoidance of new borrowing or the reduction or repayment of such other debt as the Governor-General-in-Council may think fit. Should, however, the total

of the first four items exceed in any year the amount prescribed, the balance shall be charged to capital.

4. Sums paid into the depreciation funds, if not applied within the year, shall be accumulated at interest until such time as opportunity arises for their application to the purposes of the depreciation funds."

Merits of the Scheme.—The scheme in its new form has been in effective operation since 1925-26. The sums provided from revenue on account of appropriation for reduction or avoidance of debt from year to year[1] are indicated below :—

		(In crores of rupees)
1923-24	...	3·62
1924-25	...	3·78
1925-26	...	4·97
1926-27	...	4·97
1927-28	...	5·04
1928-29	...	5·42
1929-30	...	5·74
1930-31	...	6·00

[1] Taken from the Financial Secretary's Budget Memorandum for 1930, para 45.

The amounts include the reparation receipts payable by Germany which were to be applied, under Section 7 of the Indian

provision for the reduction or avoidance of debt:

(a) a sum of 4 crores, and

(b) such additional sum as is equal to one-eightieth of any excess shown in the total of the debt outstanding on the 31st of March of the preceding year over the total outstanding on the 31st March 1923.

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1926-27	...	4·97
1927-28	...	5·04
1928-29	...	5·42
1929-30	...	5·74
1930-31	...	6·00

[1] Taken from the Financial Secretary's Budget Memorandum for 1930, para 45.

The amounts include the reparation receipts payable by Germany which were to be applied, under Section 7 of the Indian

It may be noted at this stage that, like its counterpart in Great Britain, the scheme was essentially a consolidation scheme, aiming at grouping together all obligatory and other payments connected with debt redemption, with the further advantage that it made provision for the amortization of debt obligations to be incurred in the future. As was pointed out by the Finance Member of the Government of India in 1924,[1] the amount provided for reduction or avoidance of debt in the estimates for 1923-24 was as follows:

IN INDIA:	Rs. lakhs
1½ per cent Depreciation Fund against 5 per cent Indian War Loan, 1929-47	41
5 per cent Tax-free Loan, 1945-55 ...	33
Lump-sum addition to the above made in and since 1921-22 ...	80
Total ...	154

Finance Act, 1926, to the reduction or avoidance of debt. These receipts came to 26·68 and 30 lakhs of rupees respectively in the years 1928-29 and 1929-30 (*vide* Financial Secretary's Budget Memorandum for 1929, para 33). The Finance Member announced in paragraph 27 of his Budget Speech, 1930, that he proposed to divert this amount for other purposes in future, preferably for earmarking it for the payment of accrued bonus on cash certificates.

[1] Budget Speech, 1924-25, para 30.

IN ENGLAND :

War Contribution annual instalment in repayment of principal	£ 442,900
Railway Annuities (capital portion) and sinking funds ...	1,544,300
Total in England ...	1,987,200
which at Rs. 15 ...	=298 lakhs
Total Provision ...	452 lakhs

The corresponding figures for 1924-25 on the same basis would have been 465 lakhs of rupees. Actually, the special lump-sum addition of 80 lakhs of rupees was not needed either in 1923-24 or 1924-25. There was, moreover, a slight gain from the exchange. In effect, the sums actually spent out of revenues on provision for debt redemption in those two years came to 3·62 and 3·78 crores of rupees respectively. We have shown the figures for debt redemption allotment as they would have been under the old arrangement, and as they actually were according to the new scheme. It will appear from these that, in rounding off the sinking-fund allotment at 4 crores of rupees, Sir Basil Blackett only perpetuated and placed on a statutory basis from 1925-26, a practice that was already being

followed in previous years. This, in fact, was an important argument advanced by Sir Basil Blackett in defence of the scheme: that the new sinking-fund allotment did not involve the tax-payer in any extra burden in respect of debt redemption over and above that which he had been obliged to shoulder under the existing multiple and scattered heads.[1] "When it is remembered," said Sir Basil Blackett with regard to the proposed provision for reduction or avoidance of debt for 1925-26,[2] "that the gross amount of the debt owed by the Government of India to its various creditors exceeds 10,00 crores of rupees, a provision of 4·78 crores cannot be regarded as other than modest, amounting as it does to less than half of 1 per cent of the gross amount. This figure of 4·78 crores compares with the provision of 4·52 crores in the original estimates for 1923-24, which was not based on any regular programme, but represented the aggregate amount of the specific sinking fund then in operation for specific loans."

Yet the adoption of the scheme in a systematized and regular form improved the financial

[1] Legislative Assembly Proceedings, February 17th, 1925, p. 1135.
[2] Budget Speech, 1925, para 33.

outlook in India in many respects. New nomenclature, and new arrangements for providing a sinking fund on a statutory basis, had psychological and educative value, and succeeded in restoring confidence and understanding in financial and business circles in India. It is undoubtedly a fact that the credit of the Government had been rather low for a number of years, or, to put it in other words, the Government had been obliged to offer very attractive terms. The investor was unwilling to relinquish the special war and post-war privileges attached to the public issues, such as freedom from income-tax, provision of special depreciation funds, payment of a high rate of interest, etc. Unproductive debt, moreover, stood at a very high figure. Prices of securities in India had been persistently low. Floating liabilities had just been brought within manageable proportions, but short-term maturities were still a source of very great embarrassment. Many of them bore a very high rate of interest.

"In every year," said Sir Basil Blackett in the Legislative Assembly,[1] "up to and including 1933-34, except I think 1929-30, we have

[1] On February 17th, 1925.

blocks of bonds maturing, the largest amount being 37·90 crores of 6 per cent bonds which mature next year (1926). The aggregate amount to be dealt with in the ten years is 175 crores 76 lakhs—$3\frac{1}{2}$ crores this year, just under 38 crores next year, $27\frac{1}{2}$ crores in 1927, and about $25\frac{1}{2}$ crores in 1928. These bonds carry either $5\frac{1}{2}$ per cent or 6 per cent interest, and there are some redeemable at a premium. It is of the utmost importance, from the point of view of the country as a whole, both to the tax-payer and in this instance to the railway-user too, that we should not only be able to renew these bonds in some form or other as they mature, but we should be able to renew them, if possible, at a somewhat lower rate of interest." In a subsequent paragraph of the same speech, Sir Basil Blackett estimated the total amount of money required to be financed by the central and the provincial governments in the next five years at 300 crores of rupees.

Such was the position with which the Government of India was required to deal with a firm hand. By regularizing the sinking-fund provision, temporarily stopping further direct borrowing in the market, and by an increasing use of its own reserves and balances to finance its capital programme, the Government effected

a considerable easing of market conditions. The Sinking-Fund allotment for capital expenditure by itself appreciably relieved the money market from fresh borrowing, and with this amount in hand, the Government was in a position to dictate more favourable terms for itself in its policy of conversion and re-borrowing. The prices of Indian securities began to take an upward trend, confidence was restored in the minds of investors, and unproductive debt was considerably written down. But the most important advantage gained by the adoption of the scheme was the saving that it effected in the interest charges paid out of the revenues.

Saving in Interest Charges.—The scheme enabled the Government to convert downwards a large part of its war and post-war debt, and to borrow fresh money afterwards at reduced rates of interest, with the result that the interest on ordinary debt which is charged to ordinary revenues and is consequently a burden on the tax-payer (as opposed to that which is charged to the commercial departments such as railways), has fallen steadily year after year. The following table of interest payments summarizes the whole position for the last seven years:

INTEREST PAYMENTS, 1923-30 [1]

(*In crores of rupees*)

Year	Payment in India	In England including exchange	Total	Interest charged to commercial depts.	Net interest on ordinary debt	Interest on other obligations	Total interest payment
1923-24 ...	20·10	14·91	35·03	22·08	12·55	3·01	15·56
1924-25 ...	20·30	17·25	37·56	26·28	11·27	3·61	14·89
1925-26 ...	20·76	17·35	38·12	29·04	9·07	4·29	13·36
1926-27 ...	19·82	17·48	37·31	30·44	6·87	4·90	11·77
1927-28 ...	19·89	17·56	37·46	32·09	5·36	5·19	10·56
1928-29 (revised)	20·96	17·85	38·81	34·88	3·93	6·32	10·25
1929-30 (Budget)	20·83	18·14	38·98	36·37	2·60	7·26	9·87

It is to be noticed that the net interest on ordinary debt (whereby we mean the direct loan debt, less the amount charged to commercial departments), has fallen from 12·55 crores in 1923-24 to 2·60 crores of rupees in 1929-30, or a saving in revenue of nearly 10 crores of rupees. If we make allowance for interest charges on the "other obligations" of the Government, such as Savings

[1] Compiled from the Budget Memoranda of the Financial Secretary.

Bank Deposits, Cash Certificates, Provident Funds, etc., we find that the amount of interest charged to revenue has fallen from 15·56 crores in 1923-24, to 9·87 crores of rupees in the last year under consideration, or a saving of nearly 5·69 crores of rupees.[1] During the same period, the provision for debt redemption has risen from 3·62 crores in 1923-24 to 5·73 crores in 1929-30, or an increase of only 2·11 crores of rupees.

Fall in the Rate of Interest.—It is generally assumed in all discussions on the merits of the new scheme, that all the saving in interest-charges in recent years has been due to the annual provision for the reduction or avoidance of debt. Such a statement, however, must be accepted subject to certain qualifications. According to a table given at the end of the Financial Statement for 1929-30, the unproductive debt stood at its highest point in recent years at 204·94 crores of rupees on the 31st March 1924, from which

[1] In view of the higher rate of interest paid on the sterling and rupee loans raised in the year 1930 (calendar year) and a rise in the rates of interest allowed on the Cash Certificates and Provident Funds in 1929-30 and 1930-31, a general increase in the total interest payments made out of revenues may now be expected. Thus while the budget figure for 1929-30 was 9·87 crores, the revised came to 10·78 crores and the budget for 1930-31 is put at 11·81 crores of rupees.

it has gradually fallen to 170·86 crores of rupees or by nearly 34 crores on the same date in 1929. During the same period, 25·14 crores of rupees were made available under the Debt Redemption Scheme to write off unproductive debt. Whether we consider the first amount or the second, however, the actual saving in interest-charges resulting from the reduction in the amount of the unproductive debt cannot amount to more than about $1\frac{1}{2}$ crores of rupees. But, as we have stated above, the reduction in the amount of the unproductive debt has been accompanied by the conversion of old loans to a lower rate of interest. As a typical illustration of this, we can take the case of the 1925 Rupee-loan, when 5 per cent Loan and Bonds to the extent of over $30\frac{1}{2}$ crores of rupees were issued in conversion of the following maturing Bonds[1] :

			Crores of rupees
$5\frac{1}{2}$ per cent War Bonds	1925	...	1·68
6 per cent Bonds	1926	...	17·84
6 per cent „	1927	...	7·41
$5\frac{1}{2}$ per cent „	1928	...	3·68
	Total	...	30·61

1 *Vide* Cmd., 2735, 1926, p. 11.

Not only did the rate of interest on direct loans fall, but it was brought down on other obligations, such as Cash Certificates (from 6 per cent to $4\frac{1}{2}$ per cent),[1] and on most of the Provident Funds (from $5\frac{1}{2}$ per cent to $4\frac{3}{4}$ per cent). "It is relevant to mention in this connection," says the Financial Secretary's Budget Memorandum for 1927,[2] "that in view of the terms on which recent borrowings of the Government of India have been made, the rate of interest allowed on the balances of the Provident and other similar funds has been reduced from $5\frac{1}{2}$ per cent to $4\frac{3}{4}$ per cent with effect from the 1st April 1927."[3]

Effect of Exchange on Interest Charges.—These two factors alone, however, do not fully explain the resultant saving in the interest charges of this period. The effect of improvement in the rate of exchange, which has taken place in India since 1921-22, must also be taken into consideration in calculating the reduced number of rupees paid in discharge of interest on the

[1] The rate of bonus on cash certificates has again been increased to $5\frac{1}{4}$% from July 1929, and to 6% from the 15th Sep. 1930.

[2] Para 23.

[3] This rate has now been increased to 5 per cent (*vide* Financial Secretary's Budget Memorandum for 1930-31, para 38).

sterling obligations of the Government of India. The following table shows the rate of exchange per rupee in different years :

AVERAGE EXCHANGE PER RUPEE UPON SECRETARY OF STATE'S BILLS SOLD[1]

1921-22	...	1s. 3·85d.[2]
1922-23	...	1s. 4·448d.
1923-24	...	1s. 4·534d.
1924-25	...	1s. 6·028d.
1925-26	...	1s. 6d. and 1s. 6¼d.
1926-27	...	1s. 5⅞d and 1s. 6d. and 1s. 6¼d.
1927-28	...	1s. 6d.
1928-29	...	1s. 6d.
1929-30	...	1s. 6d.

It is clear from the above table how far the rate of exchange has improved since 1921-22. An idea of the reduction resulting from more favourable exchange, in the number of rupees paid as interest on the sterling obligations, can be had from the following small illustrative table :

Year	Amount paid in £	Amount paid in rupees at the year's rate of exchange
1921-22 1927-28	7·23 million 13·12 million	10·93 crores 17·56 „
Percentage increase over 1921-22.	81 per cent	60 per cent

[1] Taken from the appendices of Financial Statements.

[2] For telegraphic transfers.

The increase in 1928 over 1922 in interest charges in terms of sterling has been 81 per cent, while the equivalent paid in rupees shows only a 60 per cent increase. If the rate of exchange had persisted at the same rate as it was in 1921-22, 21·5 crores would have had to have been paid in 1927-28 instead of 17·56 crores of rupees actually paid. The annual saving in rupees due to higher exchange is certainly not as much as 4 crores of rupees, but the rise in the exchange rate does mean some saving in relation to a figure of over £13 million annually paid in interest charges in England.

Better Adjustment of Rates to Borrowers.—Another important cause of a reduction in the interest charges which fall on direct revenues, is to be found in the better adjustment of the rate of interest paid by borrowers from the Government of India, particularly the railways and the provincial governments. In his Budget Speech for 1929-30,[1] Sir George Schuster referred to a change introduced in the method of calculating the interest chargeable to commercial departments in respect of capital outlay incurred

[1] Para 11.

after the 31st March 1917, whereby they are required to share the loss which the general revenues suffer through the tax-free concession attached to certain portions of the rupee debt. This alteration increased the amount recovered from the railways to the extent of 59 lakhs in the year 1928-29 alone. "The former method of calculation," in the opinion of Sir George, "was really erroneous, as it meant that Government did not actually recover from the Commercial Departments the interest which they were in effect themselves paying."[1]

Argument on lines similar to this will be found in the discussion on Provincial Debts, where it is shown that a part of the pre-reform provincial debt owed to the Central Government in connection with the Provincial Loan Account had slowly been converted from a low to a high rate of interest. Evidence of interest-rate adjustments in connection with advances to provinces from the Provincial Loans Fund, is also to be found in the sudden increase in the rate of interest from 5·71 per cent in 1924-25 to 7·17 per cent in 1925-26. It looks as if advances in the latter year over the previous year's balance were

[1] Ibid.

made at a rate of 12·38 per cent. It is very difficult to determine exactly what difference in the interest receipts the new arrangements with borrowers have brought about, but our object here is to point out the tendency that has been at work during the last few years towards the reduction of interest charges payable directly from the ordinary revenues.

Bonus on Cash Certificates.—In making an estimate of the interest charges borne by the ordinary revenues during the last few years, it must not be forgotten that the Government has not discharged all its obligations in respect of accrued interest, particularly in connection with the Cash Certificates. "It has to be remembered that the provision for bonus on Cash Certificates hitherto made, merely represents the amounts required to meet the actual payments, and makes no allowance for the accrued liability which is estimated to stand at $7\frac{1}{4}$ crores of rupees on the 1st October 1929."[1] The Finance Member announced[2] that this accrued liability must now be regarded as part of the Government's debt. So saving in interest charges

[1] Financial Secretary's Budget Memorandum for 1929-30, para 30.

[2] Budget Speech, 1930, para 24.

has taken place at the expense of an increase in the unproductive portion of the debt.

Increase of Capital Due to Discount on Loans.—Any estimate of the savings made in interest charges during the last few years must also take due account of the increase of debt due to the issue of loans at a discount, or at premiums on redemption. Almost all the loans during the last few years have had such attractions attached to them, whereby savings in interest charges have been made at the expense of an increase in capital. On the basis of the terms announced to the public regarding the issue of public loans, we have made our own (admittedly rough) calculations in the two subjoined tables on the basis of which it is to be inferred that the Government of India's rupee debt alone must have increased by about 7·57 crores of rupees on account of the discounts or premiums allowed on the rupee loans issued during the period from 1925-26 to 1929-30, besides £6·86 million on account of discounts and conversion operations in connection with the sterling loans. It must be mentioned, in fairness to the Government of India, that it has refrained (except in one instance only), from following the wholesale

practice which was adopted in Great Britain from 1920 to 1925 of funding short-term debt into long-term loans at the expense of a heavy increase in capital. According to the Colwyn Committee, "from the 1st January 1920, to 31st March 1925, conversions effected (in British debt) resulted in an increase of £284 million in the principal of the debt and a saving of £1,191,000, in the annual interest charge. While we do not say that such methods are never permissible, we are, in general, opposed to them, and we think that their application should at all times be very carefully watched, since they offer an easy way of lightening the immediate burden of the debt at the expense of the future."[1]

TABLE SHOWING THE AMOUNT OF DISCOUNT AND PREMIUMS PAID ON RUPEE LOANS IN DIFFERENT YEARS[2]

(*In lakhs of rupees*)

1925-26	... 87·60
1926-27	... 373·24
1927-28	... 139·55
1928-29	... 184·06
1929-30	... 82·81
Total	... 775·26

[1] Report, p. 393.

[2] These estimates are based on the information given in the "Accounts and Estimates" of the Secretary or Under-Secretary of State for India for different years.

In addition to the above, the following increases have occurred in the sterling obligations, owing to discounts on loans or to conversion operations:

(*In million* £)

1927-28 Loan ($7\frac{1}{2}$ million at $91\frac{1}{2}$)	·64
1928-29 Loan (10 „ at 91)	·90
1929-30 Loan (6 „ at 99)	·06
Conversion of 7 per cent into 3 per cent	5·26
	6·86

Better Use of Government Balances.—Two other factors have exercised an influence on the reduction of interest charges paid out of revenues, and we shall mention them briefly. In the first place, the Government's Railway Depreciation and Reserve Funds, increased from 9·08 crores in 1925 to 31·85 crores in 1929, and provincial balances from 4·83 crores to 8·09 crores of rupees. These are departmental amounts available to the Government at less than the market rate of interest. For instance, in the case of provincial balances, according to the Finance and Revenue Accounts of the Government of India,[1] the rate of interest payable on deposits made by the Local Governments and initially declared for 12 months or

[1] For 1927-28, p. 293.

over, is 1 per cent less, and that on deposits for shorter periods 2 per cent less than the rate charged by the Central Government to the Provincial Loans Fund on advances made to it during the period. Any increase in such low interest-bearing amounts held by the Government of India in its capacity of custodian of general balances on behalf of provincial governments and railways, must therefore necessarily result in a saving of the interest charges.

Secondly, cash, bullion and securities held on Treasury account stood at 57·35 crores on the 31st March 1925, and gradually fell to 30·57 crores of rupees on the same date in 1929.[1] It is evident from this that the Government freely used its Treasury balances for capital purposes, and saved the interest charges that would have had to have been paid had money been borrowed from the market.

Thus we find that the interest payments chargeable to the central revenues have fallen during the last quinquennium on account of a number of factors—easier Money Market conditions, lower interest rates, and the issue of loans at a discount or with the privilege of a redemption

[1] Financial Statement, 1929, p. 29.

premium, the rise in the rate of exchange, the reduction in the amount of the unproductive debt, better adjustment of the rate of interest paid by borrowers, the fact that the full liability in connection with the interest on Cash Certificates is not paid, the strengthening of Government's reserve and depreciation funds, and the more effective utilization of its own balances. It is not our purpose to minimize the influence of the new debt-redemption scheme on the reduction of debt charges in India, but it is only right that in appraising the true value of such a provision, we should not lose sight of the fact that even in its absence interest charges would have been reduced to some extent owing to the appearance of a number of factors that have come into play in recent years. The sole credit for the achievement, therefore, cannot go to the new Sinking Fund Scheme, although that *might* be the most important single factor responsible for the easier rates at which money was obtained by the Government for some years.

THE LIMITATIONS OF THE SCHEME

Original Allotment Based on Wrong Calculation.—So far, we have discussed the merits of

the scheme and shown how, in fact, it legalized the *status quo*. It is now our purpose to point out a few gaps and defects.

Our first criticism of the scheme is that the figure 3·66 crores originally arrived at by Sir Basil Blackett as the annual allotment needed to pay off the different kinds of debt, amounting to 805 crores of rupees, in a stipulated number of years,[1] was based on some wrong calculation. The writer is indebted to Prof. Bowley and Mr. Allen of the London School of Economics for the calculations which follow:

(i) A debt of 10,00 crores of rupees to be completely repaid in a period of 80 years, requires an annual allotment of 4·18 crores of rupees to be invested at compound interest at 4 per cent per annum. (ii) If an amount of 5 crores of rupees is annually set aside and invested at 4 per cent compound rate of interest, it will liquidate the same amount (10,00 crores of rupees) of debt in a period of 50 years. (It may be noted that in 1925-26 and 1926-27 the amount allotted under Sir Basil's scheme was slightly under 5 crores of rupees and during the last three years, the amount allotted has been over 5 crores annually.) (iii) But if an

[1] See pp. 174-75.

amount of 10 crores (the amount shown as due to New Delhi) is required to be paid off in 15 years, another of 98 crores (the amount due to Budget deficits) in 25 years, a third one of 120 crores (due to the War Debt) in 50 years, and the remaining amount of 578 crores of rupees (productive debt due to railways, etc.)[1] to be paid off at the end of 80 years, the annual contribution out of revenue if invested and re-invested at 5 per cent compound rate of interest, needed to accumulate enough to wipe off the different amounts at the end of different periods named above, would be only 2·94 crores of rupees. There was therefore some mistake in arriving at the figure of 3·66 crores as the annual contribution needed. It may be mentioned in passing that Mr. Jamnadas Mehta in his opening speech on the debate on the Debt Position of India,[2] did remark that the annual burden was "amazingly small," if the figures were properly worked out, but belonging to the Left in the Chamber as he does, his was not much more than a voice crying in the wilderness. On the original basis of the same calculations, the initial contribution was fixed at 4 crores of rupees *plus* $\frac{1}{80}$th of the increase in

1 See page 22 for our explanation of the amounts in brackets.

2 Legislative Assembly Proceedings, Vol. V, No. 17, p. 1125.

the debt over the 1923 debt figure. According to original calculations, therefore, the amount annually set apart for sinking fund is greater than it should be. It may be of interest to mention in this connection that in 1925 Sir Basil thought that the unproductive debt would take some 30 years (over 30 years, as stated then), to be completely wiped off,[1] but three years later he hoped, at the rate at which progress was being made with the debt reduction then, for its total extinction in a period of 12 years![2]

No Contribution from Borrowing Departments.—A more important criticism against the scheme is, that the total allotment towards the Sinking Fund thus provided for annually is all met out of the general revenues of the Government of India, and not out of the revenues of the borrowing departments. The total debt of the Government of India stood at 11,38'23 crores on the 31st March 1930. On the same date, cash, bullion and securities held on Treasury account, stood at 46'78 crores. The net interest-bearing obligations of the Government

[1] Legislative Assembly, 17th February 1925, p. 1158.

[2] Budget Speech, 1928, para 16.

therefore came to 10,91·45 crores of rupees which could be classed as follows:

(In crores of rupees)

(a) COMMERCIAL INVESTMENTS:	
(i) Capital advanced to Railways	731·90
(ii) Other Commercial Departments	23·05
Total ...	754·95
(b) OTHER ADVANCES TO:	
(i) Provinces	142·45
(ii) Indian States and other bodies	17·57
Total ...	160·02
(c) UNCOVERED INTEREST-BEARING OBLIGATIONS	176·48
COMBINED TOTAL DEBT ...	10,91·45

The above table shows that the "debt" is largely an investment.

The present scheme of debt-redemption does not include any provision for the amortization of advances granted to the provinces, the latter being left to make their own debt amortization arrangements. But it should likewise exclude advances given to the Native States and other bodies. We suggest that within the amount of the allotment itself, sinking fund contributions

should be made from the revenues of the commercial departments on the one hand (heads a of the table above), and from the ordinary revenues of the Government of India on the other (heads b). It is hardly fair that while the borrowings are made largely for investment in the commercial departments, the expenses incurred in connection with raising loans, and the sinking fund provision therefor, should be met out of general revenues and not out of the revenues of those departments. It may be mentioned in this connection that before 1924-25 certain railway sinking funds were included in the working expenses of the railways, but since that year, the practice has been begun of meeting them out of the general revenues. There is no doubt that since the separation of the railway finances from the general finances which was effected in 1925-26, the general revenues now receive a regular contribution out of railway earnings, but there is no use giving with one hand what is taken back with the other in a round-about fashion. Discussing the inter-relation of the railway contribution and the debt redemption provision, Sir George Schuster said[1]:

[1] Budget Statement, 1930, para 26.

"In fact, I think it is, on broad lines, correct to regard the one as balancing the other, and we shall arrive at a truer picture of what the Government draw from the Railways if we realize that, in fact, the Government get no profit but apply practically all that they receive, apart from a refund of their own interest payments, for the amortization of their capital." The following table shows the amounts of sinking fund provision made out of general revenues, and the contributions received from the railway earnings for the relief of the general taxpayer:

(*In crores of rupees*)

Year	Net railway contribution to general revenues	Sinking fund allotment
1925-26	5·49	4·97
1926-27	6·01	4·97
1927-28	6·27	5·04
1928-29	5·23	5·42

Public debt in India being largely a railway debt, railways should meet the larger part of the

debt redemption provision though their contribution to general revenues may have to be reduced. Then alone will the separation of railway finance from general finance be logically complete so far as debt charges are concerned. Such procedure was commented on with approval by the Acworth Committee. Reviewing the position of the Japanese railways under the Act of 1909, the report stated[1]: "The whole of the loans issued for railway purposes are charged against the railway account, and the railways pay over each year to the National Debt Consolidation Fund, the money required for interest and sinking fund on these loans." The lack of such provision in India is an important omission of Sir Basil Blackett's Debt Redemption Scheme, but one which can still be rectified.

Allotment Mostly Attached.—A third fact which, though valuable in some respects, is a deficiency in the scheme, from our present point of view, is that a considerable amount of the total allotment is 'attached,' i.e., it must be available for expenditure in connection with certain specified heads, such as the 5 per cent loans depreciation funds, the annual instalment in connection with

[1] Para 86.

the war contribution and railway annuities, and sinking funds for certain securities.[1] The disadvantage arising out of this position is that the total amount of money available under the scheme cannot be freely used for the purpose of buying up securities in the open market in order to raise the credit of the Government. "We are of opinion," wrote the Colwyn Committee,[2] "that in the disturbed circumstances under which loans had to be raised during and immediately after the war period, the attachment of specific sinking funds (including the depreciation fund) in certain cases proved to be of distinct advantage in securing the success of the loans. From the point of view of the use of the sinking fund in raising Government credit and facilitating operations under more settled conditions, we are, however, inclined to think that definite attachment to particular loans tends to be disadvantageous." The report states elsewhere: "Nor can it be foreseen with any certainty that the stock to which a sinking fund is attached will prove to be that which over a long period it is most desirable to support."[3] The committee as a whole

[1] See p. 192.
[2] Report, p. 217.
[3] Ibid., p. 72.

was not in favour of any extension of the ear-marking of the sinking fund to any particular securities.

In the case of India, however, we find that a Depreciation Fund was attached to the further issue of 5 per cent 1945-55 loan in the year 1925-26, while as recently as June 1929, a Depreciation Fund has been instituted in connection with the 1939-44 loan.

The allotment under any sinking fund scheme, if it is not already hypothecated, can be used as a very powerful instrument to raise the value of securities in the market, a step which safely paves the way for the issue of Government loans. "The present state of the market," wrote the Melbourne correspondent of the *Economist*,[1] in referring to the issue of a $5\frac{1}{2}$ per cent loan of £67 million to provide for the conversion of a $4\frac{1}{2}$ per cent maturing War Loan, "is largely artificial owing to the active application of sinking fund and other artificial moneys since 1st January in preparation for the conversion." Given a free allotment for the maintenance of a sinking fund, the right policy to adopt is to prop up those securities in the market which are giving the

[1] *Economist*, September 5th, 1925.

highest possible yields, allowing for their market quotations, and thus to keep a sort of balance among the market-prices of all securities. There is no justification for maintaining one particular stock above the market level by means of extra and artificial propping.

There is another important aspect of an unhypothecated sinking fund allotment. Sometimes the prices of particular securities fall to unduly low levels in the market. On such occasions, a considerable amount of the debt can be written down by buying off securities in the market at much less than their nominal value. This point is illustrated by the following table:

TABLE SHOWING THE NET YIELD OF CERTAIN LOW-INTEREST-BEARING RUPEE AND STERLING SECURITIES ON THE BASIS OF MINIMUM MARKET PRICES QUOTED IN 1928-29

Description of security and place of quotation	Lowest price quoted	Net yield on the basis of quoted price	Total approximate amount of that security outstanding	Amount at which total could be bought in the market
$3\frac{1}{2}$% Rupee, Calcutta...	71-14	4·86%	Rs. 120 crores	Rs. $86\frac{1}{4}$ crores
3% " " ...	61-8	4·87%	Rs. $6\frac{1}{2}$ "	Rs. 4 "
$3\frac{1}{2}$% London-enfaced...	$53\frac{1}{2}$	6·54%	Rs. 9 "	Rs. $4\frac{3}{4}$ "
$3\frac{1}{2}$% Sterling, London	67	5·22%	£$7\frac{1}{2}$ million	£5 million
3 % " "	60	5%	£$88\frac{1}{2}$ "	£50 "
$2\frac{1}{2}$% " "	50	5%	£77 "	£$38\frac{1}{2}$ "
		Total	Rs. 135 crores £173 million or Rs. $230\frac{1}{2}$ crores	Rs. 90 crores £$93\frac{1}{2}$ million or Rs. $124\frac{1}{2}$ crores
		or	Rs. 366 crores	Rs. $219\frac{1}{2}$ crores

According to the above table, we find that 366 crores of debt would have been cancelled by buying securities of that amount in the market in 1928-29 for $219\frac{1}{2}$ crores of rupees. Actually, of course, such a procedure is never possible on a large scale, because whenever a strong buyer enters the market in order to take advantage of the prices of low-quoted securities, their prices at once jump. Nor would such a large amount of money be available to buy securities at any one time. But our purpose is to emphasize the fact that whenever the prices of securities pass a certain limit, say 5 per cent or more, as regards their yield of interest according to market quotations, free buying should be undertaken on behalf of the Debt Redemption Scheme, even though reborrowing by the Government for other capital requirements may be necessitated. "We recommend," wrote the Indian Retrenchment Committee in 1922-23,[1] "that the purchases for the sinking funds be made periodically by open tender."

No Part of Sinking Fund in London.—The table given in connection with the argument

[1] P. 238.

raised in the preceding section shows that the range of prices of Indian securities is lower in London than at Calcutta. In the schedules of the prices of rupee and sterling securities given earlier,[1] we showed that while the maximum and minimum prices of $3\frac{1}{2}$ per cent rupee securities rose by 16 points and 13 points respectively, and of 3 per cent rupee securities by 10 points and 12 points respectively in 1927-28 over their prices in 1923-24, for $3\frac{1}{2}$ per cent and 3 per cent sterling securities, the rise was only 1 point maximum and 7 points minimum in the same period. There would therefore appear to be a special necessity for keeping a part of the sinking fund allotment in London for the purpose of buying up India's sterling securities whenever their prices fall unduly low. Both Australia and South Africa maintain branches of their sinking funds in London for that purpose, and whenever their loans are advertised, the amount of the fund which is held in London, and the extent to which it has been used there in recent times in order to buy sterling securities, always receive special mention. "The policy of the National Debt

[1] Chapter II, pp. 60 and 61, bottom of tables.

Commission," wrote the *Economist* in 1925, referring to a New South Wales issue,[1] "is now to use a portion of the sinking fund for the re-purchase of loans on the London market." The diversion of a part of the sinking fund allotment from India to London and its use for buying securities there, will materially assist in raising the prices of Indian securities in the London market. Sterling securities thus bought in London can either be totally cancelled or resold in India. That a demand for such securities exists in India is shown by the purchase of such securities worth over 40 lakhs of rupees, made on behalf of the Bombay Corporation in the year 1927-28.[2]

No Cumulative Sinking Fund.—Yet another defect from which the scheme suffers is that the sinking fund is not cumulative. So long as the amount set apart annually for sinking fund is not invested and re-invested at a compound rate of interest, and so long as a borrowing programme of the Government continues, the allotment made under the scheme

[1] December 15th, 1928.

[2] Administration Report of the Municipal Commissioner for the City of Bombay for the year 1927-28, p. iii.

will only mean a contribution out of revenues to capital expenditure. Such a provision cannot be of very material assistance in reducing to any appreciable extent the total amount of public debt. The Dominion of New Zealand, the Commonwealth of Australia, and the Union of South Africa, all keep some sort of cumulative sinking fund for the redemption of their debts. Under Act No. 50 of 1926, a cumulative sinking fund has been established in the Union of South Africa as from April 1st, 1927, to which for a period of 40 years a contribution of £650,000 per annum will be made from revenue; the proceeds of revenue derived from the mining leases will also be used for capital purposes. In referring to a recent South African loan, the *Economist*[1] pointed out that the accumulated sinking fund amounted to £14·57 million and in addition, debt had been extinguished with its help to the extent of £22 million. In February last, a part of the £6 million South African Loan issued in London was taken up by the Trustees of the South African Sinking Fund.

This is the position in the Dominions. So far as the United Kingdom is concerned, many

[1] In its issue dated October 15th, 1927.

witnesses appearing before the Committee on National Debt and Taxation, favoured the idea of a cumulative sinking fund for Great Britain. Dr. Dalton thought that any sinking fund should be at least to some extent cumulative.[1] The feature stressed in common by most of the witnesses was that the sinking fund should be increased by the addition of a part or the whole of the interest saving on debt redeemed.[2]

The establishment of a cumulative sinking fund would appear to be very desirable in India too. It is to be noted[3] that Sir Basil Blackett originally conceived the idea of a cumulative sinking fund when he referred to the increase in the annual allotment at the rate of 5 per cent compound interest. But later in the speech he abandoned the idea for the sake of simplicity. What we suggest is that the annual amount of allotment set apart from revenues under the Debt Redemption Scheme should be handed over to an independent body which should be absolutely free to utilize it either for the purchase and cancellation of old securities, or to invest it in the new loan paper. In any case, a stop should be

[1] Report, para 991.
[2] Para 994.
[3] See p. 189.

put to the present practice of utilizing a considerable portion of the amount for capital expenditure without payment of any interest thereon.

Use of Interest on Railway Funds.— The effectiveness of a cumulative sinking fund in reducing the unproductive debt and assisting the writing-down of the railway capital, will be considerably enhanced if an alteration is introduced in the mode of utilizing the interest accruing from the investment of the Railway Depreciation and Reserve Funds. These accumulative funds started in 1924-25, when the scheme for the separation of railway from general finance was sanctioned. A Depreciation Fund was started, with effect from the 1st April 1924, to provide for the cost of renewing units of all wasting assets (with certain exceptions).[1] The object of the Railway Reserve Fund, on the other hand, was to secure the payment of the annual contribution to general revenues; to provide, if necessary, for arrears of depreciation, and for writing-down and writing-off capital and to strengthen the financial position of the railways; and finally, to provide for temporary borrowings for the

[1] *Vide* Finance and Revenue Accounts of the Government of India, 1927-28, p. 164.

purpose of meeting expenditure for which there is no provision or insufficient provision in the budget revenue estimate.[1] These funds stood at 9·08 crores on the 31st March 1925, and gradually rose to 31·85 crores in 1929. They are invested on behalf of the railways and the interest accruing from their investment is credited to the railway revenues. Now, if railway finance had not been separated from the general finances, the amounts of these funds, built up out of the railway revenues, would have gone to swell the general revenues of the Central Government. It is the general revenues, therefore, that have a higher claim on the interest income derived from the investment of such funds. What we urge is that these funds should be allowed to multiply at compound interest, and their annual interest should not be treated as an incoming item in the railway revenues. Left to accumulate, they would gradually yield enough revenue to meet the annual railway contribution towards the general revenues and to provide for the railways' share of the sinking fund allotment. As we have shown on page 218, the net railway contribution to general revenues becomes very

[1] Ibid., p. 166.

small if we deduct from it the annual debt redemption allotment, for which the largest contribution should come out of the railway revenues. Railways are the biggest and the most important national industry in India, involving an investment of over 700 crores of State funds alone. They also enjoy numerous advantages arising from the State control and ownership of the industry. An investment of this magnitude and proportions, even were it in private hands, would have yielded to the State an income of several crores of rupees annually in the form of income and passenger taxes and other surcharges on the traffic. The Acworth Committee mentions how, before the war, the Prussian Railways were treated by the Parliament as "the milch-cow of the Treasury," yielding a large income, which in some years rose as high as £20 million.[1] The diversion in the fashion above suggested, of the income earned as interest from the investment of Railway Reserve Funds, will ultimately make the position of the railways financially much stronger, convert them into a veritable "milch-cow" of the Indian Treasury, and will effectively assist in writing-down

[1] Para 82.

considerably the capital invested in the Indian railways.

Establishment of a National Debt Commission.—The suggestion contained in the preceding section has only a very remote connection with the Debt Redemption Scheme of Sir Basil Blackett, but, if carried out, it could very considerably assist in writing down the capital invested in State Railways in India. But half the difficulties of the Government are due to the fact that there exists no independent organization that could take charge of, and administer these sinking, depreciation, reserve, and other miscellaneous funds in a systematie and scientific fashion. The establishment in India of a National Debt Commission, or an analogous body with much wider powers, as is suggested in the last chapter of this book, would appear to be very desirable, its work being to take over the work of debt redemption and the discharge of certain other functions. In the United Kingdom there is a National Debt Commission, composed largely of ex-officio members who receive and apply the old and new sinking funds, sell and pay life annuities, control the Local Loans and Irish Land Purchase Funds and receive and invest the funds of the

Post Office and Trustee Savings Banks, the Friendly Societies, and the National Insurance Commission.[1] There is a constant flow of money through the hands of the National Debt Commissioners into the stock market for the purchase of consols and other Government stocks, the source of the funds being such Government Departments as the Currency Note Account, the Public Trustee, the Official Trustees of Charitable Funds, the Supreme Court of Judicature, and the India Office for its Gold Standard and Paper Currency Reserves. "Together they make one of the most important groups of customers which buy Government stocks in regular and large amounts; and their proceedings have no little effect on the market therein upon the Stock Exchange. The National Debt Commissioners thus act as a conduit pipe through which money is constantly running out of the pockets of depositors in Savings Banks and others, and into those of dealers in consols and Government stock."

"Acting under the instructions of the National Debt Commissioners, and in the light of their professional skill and knowledge of the stock

[1] See e.g., E. Hilton Young: "The System of National Finance," pp. 263—65.

markets, the Government brokers make their purchases gradually and according to the state of the market. Pursuing the obvious end of getting as much stock for as little money as possible, they buy more when the price is low, and less when the price is high, and always a little at a time, so as to avoid raising the price of the stock against themselves by running the market short of supplies. In the appearances of the Government brokers on the Stock Exchange, and in their purchases there, we see actually at work the process of maintaining the credit of the nation by the redemption of its debt. The object of maintaining its credit is in order that, if it has to borrow again, it may be able to do so easily and cheaply."[1]

It may be remarked here that different kinds of Stocks, such as those directly charged upon the Consolidated Fund, the Local Loans, or the Guaranteed Irish Land Stock have their own arrangements of funds for redemption. Also "an annual return of the investments so made is rendered by the National Debt Commissioners to Parliament."[2]

In the United Kingdom, the work of the National Debt Commission is of a restricted

[1] Ibid., p. 282. [2] Ibid., p. 265.

nature. It is concerned mainly with the investment of departmental and sinking fund moneys and the purchase of securities in the market on behalf of those funds. The work connected with the payment of interest, and the issue of fresh loans, whether short-term or long-term, is still done by the Treasury. In France they have gone a step further. Here the *Caisse D'Amortissment*, an organization providing sinking funds for the extinction of short-term and floating debt, was established by Poincaré's government in 1926. This body has taken entire charge of the interest services and the reimbursement and renewal of the whole of the National Defence and Treasury Bonds, with assigned revenues and surpluses, and is administered by a Board of Directors consisting of 20 members.[1] In the Union of South Africa, the management of public debt is vested in the Public Debt Commission which includes a member of the Railway Board, and another member appointed by the Governor-General under the Act of 1911, with the Finance Minister as Chairman. "Since 1923, the total amount of interest due by the administration on the railway and harbour capital, whether the latter

[1] See e.g., *Economist* (Paris Correspondent), August 7th, 1926.

was obtained from loans or from general revenues, has been paid direct to the Public Debt Commissioners, instead of first into the Revenue Account as was formerly the case."[1]

Such are the arrangements which other countries have made for the administration of their public debts. The examples cited give us sufficient guidance to determine what should be the constitution, scope and functions of an Indian National Debt Commission. We revert to this question again in the last chapter, where we propose the setting up of a " Board of National Investments " which would undertake the functions connected with all the branches of the public debt. These functions would be the issue of public loans and their conversion, the purchase and sale of securities in the market, the transfer of sterling securities to India, the investment of sinking and other funds, the payment of interest on the debt, and its discharge. Whether it is called a National Debt Commission, or given the more grandiloquent title of a "Board of National Investments"; however, the most important step it can take will be to split up the whole of the Indian Public Debt among the railways,

[1] De Dock: "Finances of the Union of South Africa," pp. 366-67.

provinces, native states, harbours, municipal corporations and other borrowing bodies that now bank with the Government of India, to fix up periods for the redemption of their debts of different kinds, to arrange for interest and sinking funds to come from these bodies directly to its own account and to provide for the extinction of the unproductive debt out of the general revenues of the Central Government. The total amount of money thus received will not be lost—it will still be available for the capital requirements of public bodies. But the step would mean the co-ordination of all the functions connected with the administration of the Indian public debt. The conversion of short-term maturities is a problem by itself, and India would do well to follow the example of France, and to set up an independent body to take care of early-maturing public debts. In general, however, only the establishment of an institution on the lines of the one suggested above will insure the redemption of India's public debt.

CHAPTER V

THE SMALL INVESTOR

In the first four chapters we have dealt with the position of the Indian Public Debt from the borrowers' point of view. Let us now devote some attention to the problems of the investor. We shall deal first with the nature, origin and development of the existing facilities for investment open to the small investor, and then with the modifications needed to expand such facilities and make them more effective.

The small investor was once defined by a contributor to the columns of a leading British financial paper as "the person who .... is only 'small' in the sense of being unused to doing much investing, who is out of touch with the routine of our great financial institutions, and has never had ... the daily spectacle of the inside working of that extraordinary contraption, the British credit system, before his eyes."

The essential characteristic of the small investor in India is also that he is not used to much investing. For the purpose of our discussion, we define a small investor as one who utilizes investment facilities of the type now provided through the Post Office.

Existing Facilities for Small Investor.— What then are the existing facilities offered by the Post Office for investment? Broadly speaking they are four:

(i) The Post Office Savings Banks;
(ii) Post Office Cash Certificates;
(iii) Occasional issues of regular Government loans through the Post Office;
(iv) The purchase, sale and safe custody on behalf of investors of Government Paper, by the Accountant-General of Posts and Telegraphs under certain conditions laid down by the rules.

The first two facilities are always on offer. The third was a war and post-war development and has been discontinued in recent years. The existence of the last is not very largely known. Let us now trace the development of each one of them :

POST OFFICE SAVINGS BANKS[1]

District Savings Banks were started by the Government in 1870. No depositor was allowed to deposit more than 500 rupees annually, up to a maximum holding of 3,000 rupees. The rate of interest offered was $3\frac{3}{4}$ per cent. In December 1879, the maximum limit of holding was raised to 5,000 rupees and the rate of interest increased to $4\frac{1}{6}$ per cent with the result that large savings were attracted, which, it was alleged, would otherwise have gone to banks. In 1880, therefore, the maximum limit was reduced to 3,000 rupees, and interest on deposits to $3\frac{3}{4}$ per cent.

The district savings banks were opened at all convenient centres; the existing Post Office Savings Banks were opened in 1882 in every part of India except the Presidency-towns. The result of the first year's working was 39,121 depositors with a balance of 27·96 lakhs. A few years later, in 1886, the old district savings banks were abolished, and their balances were transferred to the Post Office Savings Banks, but local Government Savings Banks remained

[1] For the facts on which this section is based, see Sir Geoffrey Clarke's "Story of the Post Office in India."

in existence in Calcutta, Madras and Bombay up to 1896.

In 1904, fearing the possibilities arising out of the "call" nature of the money in these deposits, the Government made an attempt to secure their conversion into "time" deposits by offering an extra $\frac{1}{4}$ per cent on moneys callable at six months' notice only. Needless to say, however, this attempt on the part of the Government to lock up small deposits by offering the investor an extra one-third of a penny per month per deposit of 100 rupees evoked but little response, and the concession was withdrawn in 1908.

Immediately before the war the maximum holding limit was raised to 7,500 rupees, the effect of which has been to encourage the growth of further deposits in the postal savings banks. There are now well over twelve thousand of these banks in India, with over 26 lakhs of depositors and a total holding of 32·66 crores, representing an average of 125 rupees per depositor. The rate of interest offered is 3 per cent per annum, on the minimum monthly balance, and the depositor can make withdrawals once a week. A table showing the growth of savings banks deposits, compiled from the appendices of Indian Financial Statements, is given at the end of this section.

From 1882 to the present time, the Postal Savings deposits have consistently shown a steady increase. The aggregate balance to the credit of the depositors has been greater than in the previous year except in four instances only. It fell in 1897-98, then in 1914-15, and again in 1917-18, and lastly in 1921-22. The most important fall occurred at the outbreak of the war but was mostly confined to Bombay where depositors, hearing rumours that the German Government had confiscated the deposits in the savings banks were panic-stricken, and withdrew nearly nine crores of rupees at one time. The slump in 1897-98 was due to famine and very high prices. The explanation for the heavy withdrawals in 1917-18 is to be found in the introduction of the system of cash certificates and the intensive propaganda for the first War Loan (1917), and the consequent diversion of postal savings bank moneys in those two directions.[1] No explanation is offered officially for a small fall in the year 1921-22, the year of the non-cooperation movement, which was also marked by a slump in prices and trade. It is stated on high authority that these balances have

[1] *Vide* 1918 Budget Statement.

remained unaffected by the heat of political controversies.

Let us now make a few comments on the working of the Post Office Savings Banks System. The number of post offices in India is about 20,000, that is to say, 40 times the number of existing bank offices. The business of the savings banks is carried on by over twelve thousand offices. The Post Offices penetrate into the rural areas and are quite evenly distributed. Once they became so popular as to attract the attention of the rural classes, they would form a linked system of centres for the concentration and mobilization of the small savings of the rural community.

Another important thing that attracts attention in connection with Postal Savings deposits is, that while their aggregate balance increased from 9·6 crores at the opening of this century to nearly 24 crores of rupees at the outbreak of the war—or an increase of nearly 150 per cent in 14 years—they have made little progress from 1914 to the present day, a period of equal length in which they have increased only by about 9 crores of rupees or 40 per cent. Another point to be noticed is that the average amount of each deposit has, on the whole, in spite of occasional fluctuations, remained more or less unchanged, it being 122 rupees in

1900 and 125 rupees in the year 1927-28.[1] It is interesting to observe, however, that while the number of depositors in the first 14 years of this century increased, very roughly, by over eight lakhs, in the second 14 years the increase was about ten lakhs. This shows in other words that the Postal Savings Bank institution is becoming popular with an increasing number of small investors who tend to keep down the average of each depositor to a low figure. It is suggested here, therefore, that improvement in the existing facilities to the small investor in several directions is the remedy so that he may be encouraged to leave larger balances with the Post Office.

The distinction should be frankly made between the case of Post Offices at places where there are bank branches, and where there are none. In the latter cases, on all deposits of 100 rupees and over, the rate of interest should be increased to 4 per cent, and on fixed deposits of over 100 rupees made for 6 months and over, to $4\frac{1}{2}$ per cent. Even in towns where banking facilities exist, the

[1] According to the latest figures (1928-29) which became available to the present writer after this chapter had been written, the number of accounts fell by about 6 lakhs and the average of each deposit rose to Rs. 170 in the year 1928-29.

rate should be increased to $3\frac{1}{2}$ per cent on all deposits of 100 rupees and over. The above proposals would provide a stimulus to the very small depositor to bring up his minimum balance to the level of a hundred rupees and rapidly encourage the growth of postal deposits in districts not served by bank branches. "We think," says the Report of the Liberal Industrial Enquiry,[1] "that the Board should pay special attention to the provision of Bonds of a type suitable to the small investor, and that in this connection the Post Office Savings Bank should be reorganized on terms more favourable to the depositor; for we believe the Post Office Savings System is capable of great expansion if the terms are improved and popularized." On an earlier page, the Report affirms that, "the Savings Bank could afford to pay $3\frac{1}{2}$ per cent to its depositors instead of $2\frac{1}{2}$ per cent."[2] The same remarks apply with even greater force to Indian conditions where banking is still in a very undeveloped form, the rate of interest in the rural areas high, and the need of public borrowing so great. There is a general tendency in other countries, to liberalize the facilities to the small investor provided through

[1] "Britain's Industrial Future," p. 112.

[2] Ibid., p. 106.

the Post Office Savings Banks. Only just recently there have been extensions in the facilities provided in Great Britain; e.g., in respect of facilities of withdrawal, or in the removal of the prohibition against a depositor having more than one Savings Bank Account in favour of beneficiaries.[1] In Britain also, the depositor may effect the withdrawal at any of the 14,000 offices which transact Savings Bank business.[2]

Need for Postal Cheque System.—Although the Committee that enquired into the possibility of the introduction of a Postal Cheque System in Great Britain (1928) did not favour its adoption for that country in view of the highly developed banking system there, many Continental countries, including Germany, France, Austria, Belgium, Holland, Czecho-Slovakia, Switzerland, Hungary, Yugo-Slavia, Italy and Denmark have developed a postal cheque system, which, in most cases is working at a profit.[3] The introduction of a full-fledged

[1] See e.g., *Times*, November 23rd, 1929.

[2] Somewhat similar suggestions for the remittance of money have been recommended by the U. P. Banking Enquiry Committee (August 1930).

[3] *Vide* Cmd. 3151, 1928.

system of Postal Cheques may be a premature step in India too,[1] although for different reasons, but we suggest a much simpler course for adoption that would very largely succeed in achieving the same object. While the ordinary system of withdrawing money from the Savings Bank should continue for those who use the Bank as a real saving institution and do not want to be bothered by a round-about system of withdrawing money, it would be advantageous for the post office to issue deposit receipts, a kind of crossed warrants[2] for convenient amounts to each depositor to the extent of his full bank balance for a nominal payment, receipts which the depositor may pass on to others to whom he has to make payments. These crossed warrants would soon become a sort of paper currency, and their use by the post office savings bank depositors would serve to bring the non-users into the postal savings system. The experiment could first be tried in particular areas, to be extended later. Depositors would then begin to keep larger balances with the bank, there would be saving

[1] The U.P. Banking Enquiry Committee has recommended that Post Office cheque accounts may be tried in places where modern banking facilities do not exist.

[2] Which are in Britain already in limited use.

in the use of metallic currency, and a larger number of persons would become familiarized with banking habits.

A final comment remains to be made in connection with the risk to which the savings bank system is liable, and the possible dangers to the Government, in holding such large amounts of money at call. It is rather regrettable that in two respects people on the Bombay side have abused the system. In the first place, on all occasions of crises they have exhibited the greatest nervousness, and hurriedly withdrawn their money from the post offices; and secondly, the institution has been used as a convenient instrument for keeping large amounts of money readily available at call—not only by one person in his own name, but by the control of more than one account by one individual, who can thereby call large amounts of money from a single post office. Sir Geoffrey Clarke, the late Director-General of Posts and Telegraphs,[1] narrates several such cases in which embarrassment has been caused to the postal savings bank authorities. "There is reason to believe," he has written, "that a number of wealthy persons belonging to

[1] In his interesting book "The Story of the Indian Post Office."

the commercial class use the Postal Savings Bank in Bombay as a convenient place to deposit money. The rule which permits a depositor to have accounts on his behalf or on behalf of any minor of whom he happens to be the guardian, has opened a way to great abuse of the system." In times of crises, he states, the accounts in respect of all these imaginary relatives threaten to be withdrawn. One depositor at Dharwar was authorized to operate on 83 accounts, with a balance of nearly 30,000 rupees; and he could have controlled a much larger balance if he had cared to. Another depositor in Bijapore controlled 42 accounts, a third at Surat 30, and another at Karwar 19. Such persons are really in a sense speculators and a danger to the savings bank system. Their deposits, according to Sir Geoffrey Clarke, represent a very high percentage of the total deposits in India, so that the action of any strong body of depositors in Bombay has a very serious effect on the aggregate balance of all the savings banks in India. When the Government was thus embarrassed by the postal depositors at the outbreak of the war, it had to negotiate two short-term loans in the London market, one of £7 million from the Gold Standard Reserve, and the other of £4 million by means of the issue

of India Bills, in order to be able to retain funds in India, sufficient to pay depositors their money on demand.

THE PROGRESS OF SAVINGS BANKS IN INDIA[1]
1899—1929

Year	No. of P. O. Savings Banks	No. of accounts in P. O. S. Banks	Amount deposited in S. Banks (in Rs. crores)	Average of each deposit	Net additions to deposits (in Rs. lakhs)
1899-1900	6,479	785,729	9·64	122·77	21·84
1900-01	6,636	816,651	10·04	122·98	39·68
1901-02	7,053	866,693	10·68	123·25	63·88
1903-04	7,372	987,635	12·33	124·88	91·21
1904-05	7,855	1,058,813	13·40	126·62	107·32
1905-06	8,071	1,115,578	13·99	130·83	58·56
1906-07	8,049	1,140,220	14·76	133·99	77·43
1907-08	8,328	1,262,763	15·18	120·22	41·44
1908-09	8,501	1,318,632	15·23	115·53	5·27
1909-10	8,767	1,378,916	15·86	115·07	63·30
1910-11	8,929	1,430,451	16·91	118·28	105·16
1911-12	9,502	1,500,834	18·89	125·92	197·97
1912-13	9,460	1,566,860	20·61	131·55	171·29
1913-14	9,824	1,638,725	23·16	141·38	255·60
1914-15	10,161	1,644,074	14·89	90·58	—827·49
1915-16	10,386	1,660,424	15·32	61·94	42·89
1916-17	10,421	1,647,419	16·59	100·73	127·40
1917-18	10,975	1,637,600	16·58	101·27	—1·06
1918-19	10,587	1,677,407	18·82	112·22	223·08
1919-20	10,670	1,760,442	21·34	121·26	252·39
1920-21	10,713	1,877,957	22·86	121·73	151·37
1921-22	10,758	1,958,324	22·26	113·68	—59·96
1922-23	10,730	2,043,502	23·19	113·52	93·73
1923-24	10,535	2,089,314	24·78	118·64	158·84
1924-25	10,727	2,164,473	25·63	118·45	85·11
1925-26	11,162	2,317,390	27·23	117·50	159·19
1926-27	11,994	2,518,142	29·50	117·19	227·74
1927-28	12,326	2,606,071	32·66	125·34	315·78
1928-29	12,684	2,020,832	34·49	170·67	182·39

[1] Compiled from the Appendices of Financial Statements.

THE POSTAL CASH CERTIFICATE SYSTEM

While the postal savings bank system has played in the past quite an important part in providing a convenient institution for the small savings of the community, the recently introduced Cash Certificate system is likely to assume an even more important rôle in the future in providing funds for the State. What the former achieved in 48 years, the latter has accomplished within a space of 13 years. It is to be recalled that the first attempt to popularize an investment system of a similar nature was made in 1882, almost simultaneously with the introduction of the postal savings banks, when what were known as "stock certificates" or "stock-notes" were issued through the Treasuries in denominations of $12\frac{1}{2}$, 25, 50 and 100 rupees, bearing 4 per cent interest, payable annually. While the postal scheme won through, the Treasury experiment was a failure. Apart from the greater popularity of the post office as a people's institution, an essential difference between the postal and treasury systems was, that while one kept the money on demand, the other attempted to lock up the savings of the small investor indefinitely. In six years, the total amount

of money invested through the Treasury plan amounted to 16 lakhs of rupees, as contrasted with nearly 28 lakhs in the Postal Savings Banks at the end of the first year. "The stock-note scheme of 1882 proved a complete failure owing largely to the fact that subsequent depreciation of Government Paper rendered these notes transferable only at a loss. Moreover, the interest payments were necessarily very small and accrued yearly." The main fault that wrecked the stock-note experiment of the early eighties, however, was that it "was in effect merely an attempt to apply the conditions of an ordinary irredeemable loan to very small subscriptions."[1] The practice was discontinued in 1888, and the holders of 100 rupees or less were paid off in that year. As we shall see later, more recent attempts to popularize the regular forms of government loans through the post office have likewise not had any great success, and the practice has once more been discontinued.

Far different, however, has been the experience with cash certificates. Cash Certificates in India are the counterpart of what are known as Savings Certificates in England, Obligation Bonds

[1] Financial Statement, 1917, paras 87 and 90.

in France, Thrift and War Savings Stamps and War Savings Certificates in the United States of America. In India, the institution of postal cash certificates has been one of the most remarkable developments of war and post-war financial conditions. Originally instituted by Sir William Meyer in 1917, following the example of the war savings certificates introduced in Great Britain a year earlier, these certificates, after surviving the first shock of maturity about the year 1922, have shown steady improvement during the last few years. In fact, from 3·13 crores of rupees in 1923, they have risen to 35 crores in seven years. Their accumulated interest liability amounts to over seven crores of rupees. They have thus yielded about five crores of rupees net annually, a larger amount than before the war could be raised yearly by the Government of India with the help of its whole loan organization. With a large population scattered over nearly 700,000 cities, towns and villages, saving through postal institutions has more potentialities in India than any other immediately practical method.

Oraganization for Pushing Savings.— In Great Britain, the sum raised through savings certificates has gradually amounted to

nearly £500,000,000 in just over a dozen years. For some time past, their sale has amounted to about a million per week. In fact, in Great Britain, a most remarkable saving organization has been developed. The work of organizing the movement and extending its sphere of usefulness is entrusted to an independent National Savings Committee that starts new Savings Associations, forms Local Committees, convenes regional conferences, holds a National Savings Assembly, invites eminent speakers to help the movement, frames new savings schemes, keeps in touch with employers and others likely to make use of new proposals, and co-operates with related bodies in fostering thrift movements, submitting annually a report to the Treasury giving an account of its activities. Many private institutions have branches of the National Savings Association which exist to encourage the sale of savings certificates. The number of such savings associations in Britain was reported to be 28,174 on the 31st March 1929.[1] Various schemes have been devised whereby such certificates are purchased by subscriptions raised from the contributions of both employer and the

[1] *Vide* National Savings Committee Report for 1928-29.

employee for the benefit of the latter. In fact, in popularizing the movement among the poorer classes, the plea has been put forward by the wealthier classes that they themselves cannot save much owing to high taxation and the loss of profits in basic industries; the great mass of people should, therefore, patronize the National Savings Certificate movement, and thus relieve the money market from government borrowings.

Below we give a comparative table of issues and discharges of savings certificates in England and cash certificates in India, for a number of years:

A COMPARISON OF BRITISH SAVINGS CERTIFICATES AND INDIAN CASH CERTIFICATES, 1916—30[1]

Year	Great Britain (Savings Certificates) Issues (A)	Discharges (B)	Percentage of B to A	India (Cash Certificates) Issues (C)	Discharges (D)	Percentage of D to C	Outstanding Rs. Crores
	(Million £)			Crores of rupees			
1916-17	76	1	...	...	...	...	...
1917-18	67	3	...	10·00	1·12	...	8·88
1918-19	98	9	...	4·03	7·16	...	5·75
1919-20	72	25	...				
1920-21	41	30	73	1·00	2·41	...	4·43
1921-22	93	36	38				
1922-23	40	28	70	·70	1·91	...	3·13
1923-24	45	33	73	6·91	1·62	30	8·42
1924-25	32	29	90	6·10	1·40	23	13·12
1925-26	35	28	80	9·55	1·70	18	20·97
1926-27	32	36	112	7·53	1·82	24	26·68
1927-28	38	47	124	6·09	2·06	34	30·71
1928-29	42	43	103	4·90	3·29	67	32·32
1929-30	...	...	...	7·15	4·45	62	35·00

1 The figures for Britain are from the Reports of the National Savings Committee, the Indian figures from the Reports of the Controller of Currency.

The table shows that while the percentage of discharges to new issues in England has ranged between 70 and 124 since 1923 (in the last three years discharges having been distinctly greater than the new issues), the same ratio in India has been 34 per cent at its highest and 18 per cent at its lowest between 1923 and 1928, and rose to 67 per cent in 1928-29 and to 62 per cent in 1929-30 for special reasons that we shall presently explain. There is no doubt that in the first few years of their flotation there were heavy withdrawals of cash certificates in our country. It is well known that many people subscribed to Government loans under official pressure. "It would seem," said Lord (then Sir James) Meston in explaining the heavy discharges of those certificates in his budget speech of 1919, "that in the operations of the first War Loan, the zeal of the canvassers occasionally outran their discretion, with the result that in some years, those who took up certificates presented them not long afterwards for encashment in considerable quantities. Apart, however, from this, it is not unnatural that in a year of scarcity, some proportion of those having their funds invested in this way, should have found it convenient to realize them. The present indications are, that the

weaker holders are in process of being eliminated; while, therefore, we estimate that in the coming year the receipts and payments will balance each other, we can hope that gradually, the merits of the cash certificates as a form of investment for the small man will be more and more generally appreciated." Lord Meston's hopes did not begin to be fulfilled until three years later. In the circumstances, it is not surprising that the postal cash certificates did not receive a fair trial during the first few years. The times, moreover, were not very propitious for the growth of this novel experiment, because another equally important, if not actually more important, reform was being pushed through, namely, that of popularizing currency-notes amongst an illiterate and ignorant population. A view quite liable to take hold of the masses was that the Government was becoming bankrupt; it was issuing paper money instead of metallic money; and to postpone its bankruptcy, it wanted loans from the people. Distrust of the Government Paper was so great at certain places, that at times it became very heavily depreciated. Sir James Brunyate of the Finance and Currency Department of the Government of India said before the Babington-Smith Committee of 1919 that "having

heard that some of these loans were being bought up at a considerable discount, as much as 70 or 75 rupees, the ordinary market value in Bombay being considerably nearer par, we told the district authorities that we would be prepared to redeem them before their time and pay out in rupees." No tenders, however, were made except one in the Central Provinces.

It was in these circumstances that cash certificates were discharged in considerable quantities. If the infant cash certificate system weakened very much in its early infancy—it gradually diminished from the 9 crores to which it grew within the first year of its birth, to a little over 3 crores of rupees in 1923—it has shown more than ordinary vigour since it has stood upon its own legs. As shown by the figures just quoted, the Indian small investor in Postal Cash Certificates since 1923 has shown a remarkable capacity to hold on for the full term of five years.

The terms of issue of Indian Cash Certificates are as follows: They are issued in denominations of 10, 20, 50, 100, 500 and 1,000 rupees, at a discount: the issue-prices of the above amounts are respectively 7-8, 15, 37-8, 75, 375 and 750 rupees, the full

denominational amount being repayable at the expiry of five years which works out at 6 per cent compound interest. The investor, however, has the option of demanding his money at any time, without any interest at all during the first 12 months, but at a progressive rate of interest afterwards, rising from 4 per cent at the end of the first year, to about 6 per cent in the fifth year. An individual can hold these certificates to the maximum nominal value of 10,000 rupees. They are tax-exempt. Originally they were issued at $77\frac{1}{2}$ per cent, in 1923 their yield was made more attractive and they were issued at 75; the old rate of $77\frac{1}{2}$ per cent was restored in April 1926, and in July 1927 the yield was further reduced by raising the issue price to 80 per cent. In July 1929, the issue price was again reduced to $77\frac{1}{2}$ per cent. With effect from September 15th, 1930, they have been ordered to be issued at 75, thus restoring their yield to 6 per cent.

Attractive Form of Investment.—These certificates are now an attractive form of investment to the middle-classes and present a combination of features not available in any other form of banking, industrial or government investment.

"Safety first" being the dominant consideration in the mind of the small investor, it is only natural that this form of investment, secured by the State, should be to him distinctly preferable to either a fixed deposit in a shaky bank, or to locking up money in industrial securities of an uncertain or problematical character regarding which he has little expert knowledge. Nor would he care even if he had a large enough sum, to lock up his funds in a long-dated government loan, however attractive, for fear of not being able to get the money at a time when he required it, possibly for the marriage of his daughter, or a house-lease, or for some kindred purpose, for which he had been laying by all this amount of money. Regular government loans, moreover, come and go (once a year), in most cases unknown to the small investor. The yield on them may be sometimes more attractive than that on the cash certificates, but he does not understand the significance of discounts, premiums, or conversion terms. He attaches more importance to the facility with which he can at any time make an investment through the post office, and the rapidity with which he can transform his securities so obtained into liquid funds through the same institution. These are

the reasons why the cash certificates are popular everywhere, and why they are so fairly evenly distributed among investors in different provinces (see table below), and not largely confined, as are the holdings of regular government loans, to the commercially advanced provinces.

STATEMENT SHOWING THE AMOUNTS OF 5-YEAR CASH CERTIFICATES OUTSTANDING ON THE 31ST DECEMBER 1929, IN THE DIFFERENT POSTAL CIRCLES [1]

(In crores of rupees)

Names of Postal Circles	Amount of principal outstanding on 31st December 1929
Bengal and Assam	6·39
Bihar and Orissa	1·36
Bombay	10·50
Central	2·40
Sind and Baluchistan ...	1·49
Punjab and N.-W. F. ...	4·55
The United Provinces ...	5·08
Madras	2·06
Burma	·59
TOTAL IN DECEMBER 1929	34·47
" " " 1928	32·15
" " " 1927	30·21

But does the small investor regard the encashable character of these certificates on

[1] From the *Gazette of India*, March 15th, 1930, p. 448.

demand as an indispensable price for his investment? Has he shown any relaxation in that respect? The investor in India, however small, is certainly wealthier than the average man of the poorer classes. It will not perhaps be disputed that the Indian mentality underlying money-lending favours, within limits, the locking-up of money for certain periods, on the strength of the prospect of getting a large amount of money as interest in one sum. The existing term of limitation on land mortgages is 12 years. Even on unsecured debts by means of ordinary promissory notes, the term is three years. These terms of limitation at least show the way the wind blows, namely, that one who saves in India in order to invest money, saves it for some time, and when once he parts with it, he is prepared to take the risk arising from the fact that he will not be able to get his money till after a few years. One more proof of this contention is to be found in the fact that, in the post-war period, the Cash Certificates in India, as in England, have grown at the expense of Savings Bank deposits. The war and post-war period has been a period of expansion and growth in the creation of capital in India. Banking deposits and joint stock capital have considerably increased. Why

then should not the postal savings bank deposits have kept pace during this period, with even their pre-war rate of increase? Why did they increase by only 40 per cent in the 14 years of war and post-war period, whereas they had developed by 150 per cent in the first 14 years of this century? It shows, if anything, that the small investor has learnt to make a distinction between a current deposit in a Savings Bank and an investment in Cash Certificates, with a preference for the latter, and that he distinctly appears to be prepared to part with his money for some time to come. The latter conclusion is particularly borne out by the tenacity with which he has held on to his certificates for the full term for some years during the past decade.

Issue of Cash Bonds Recommended.— It is our view that the time has surely come when, in addition to the existing Certificates which are encashable on demand, fresh Cash Bonds of ten and fifteen years' maturity, not redeemable within the first five and ten years respectively, should be issued, with 5 and 10 per cent premiums attached to them if they are held for the full term of maturity. The existing

holders of 35 crores of rupees in Cash Certificates also might be given an opportunity to convert their existing holdings into new Cash Bonds to which attractive premiums, it is proposed, should be attached. Any conversions so effected would reduce the demand liabilities of the government, and increase their time liability correspondingly. France has tried successfully Obligation Bonds and "Obligations de la defense Nationale" certificates, which are differently redeemable, at the option of the holder, at the end of six or eighteen months, at an increasing premium if held till maturity.[1] In England, too, the one policy that the Treasury has consistently adopted is the continued provision of such options to the holder of the savings certificates as will enable him to keep that money in the existing form for as long as he may care to do so. He has also been given the further option of converting his holding into a longer-term loan. According to the decision of the Treasury arrived at in 1926,[2] the holders of the first batch of Savings

[1] The Central Bank of India has recently issued its 3-year Cash Certificates, allowing a low rate of interest if cashed in 6 months and a progressively higher rate if held till maturity.

[2] On the recommendation of the Committee on the Maturity of Savings Certificates. Cmd., 2610, 1926.

Certificates issued between 1916 and 1922 can continue to hold them at least up to 1932 (some people thus being enabled to hold for a period of 16 years). But "hanoz Delhi dur ust" (Delhi is still far away), and there is nothing to prevent the British Treasury from appointing another committee in the meantime to suggest how the period of such Savings Certificates can be further prolonged. As early as the year 1919, in Great Britain, the period for which certificates might be held was extended to ten years. In India too, certain issues of cash certificates have been allowed to be held for another term of five years. But what we advocate is the extension of the system of what might be called "deferred investment" by the issue of 10- and 15-year certificates. "We think," wrote the committee above referred to, "that ultimately the aim of the movement must be to direct the attention of the small saver to longer-term investment, by which alone the maximum yield on his savings can be realized, and we suggest that the new conversion security, while connected with the Savings Movement, should approach in some degree to the more normal type of security appropriate to longer-term investment, and that it should be in a sense intermediate in form between the more normal type of security

and Savings Certificates."[1] The longer-term certificates, called Cash Bonds, the introduction of which we have suggested, would fulfil all the above requirements besides being specially suited to Indian conditions. That such longer-term certificates are bound to be a success is amply demonstrated by the popularity of the short-term bonds issued by the Government in the war and post-war period.

Desirability of Conversion Facilities.—In addition to the issue of what we have called Cash Bonds, carrying a cumulative rate of interest, facilities should be permanently provided for the conversion of existing certificates into the 5 per cent or any other long-term loans, with freedom to the new bond-holders to demand redemption at six months' notice under certain conditions. Within moderate limits even the Cash Certificate-holder should be allowed to use his new acquisition as a credit-instrument, to provide himself with funds temporarily through a bank if need be.[2] Following the example of Britain, the terms of cash

[1] Ibid., p. 9.

[1] The U.P. Banking Committee has recommended that up to a maximum limit in any case, Cash Certificates should be made negotiable.

certificates of all issues should be made without distinction ten years instead of five, with the payment of $\frac{1}{2}$ anna per month as interest on each certificate of 10 rupees after the latter has run its usual course.

Rural Certificates.—For those who have grown familiar with the system we have advocated the adoption of a bolder policy of issuing longer-term certificates not repayable in the first few years but carrying mortgage rights—though without the sacrifice of any of the other existing facilities—and favoured the gradual raising of the maximum individual holding up to 40,000 rupees, this being the minimum which yields roughly the minimum taxable income as interest.[1] All this should be subject to the proviso that not more than 5,000 rupees would be allowed to be withdrawn in any one year. But for the purpose of bringing in that class which has so far avoided the system as a dangerous net intended for the entanglement of the unwary, we favour the introduction of Rural Certificates, which might carry the further privilege of acceptance at Treasuries

[1] This is by no means unprecedented; in Australia the maximum individual holding is £ 1,000. Nor need all of the holding be tax-free.

in payment of taxes. A more handsome rate of interest should be allowed on them in order to make them sufficiently attractive even from the yield point of view to the very small and suspicious investor. The individual holding, however, should remain only at the figure of 200 rupees, to be reached, say, in a period of four years. It would perhaps be better if they were issued at 6 per cent for a period of 12 years, during which a sum at that rate would automatically double itself. At a low rate of interest, this practice could gradually develop into a kind of annuities system. It is a fact of much relevance here, though not generally known, that England in the more primitive days of her debt development, adopted the practice of issuing Exchequer Bills in denominations of £10 and £5 which served as a medium of circulation, were negotiable, and passed current by endorsement, bore interest, were receivable by the government in payment of all taxes except land tax, and could be re-issued. Interest lapsed only during the time they remained in the Treasury, and they were exchangeable for ready money on demand at the Bank of England. The Bank was allowed 4½ per cent per annum commission for circulating such issues, while the amount of the issue was

regulated by raising or lowering the denominations of the Bills.[1]

In the rural communities of India, we have today a population not so very different in its prejudices and conservatism from that of England a few centuries ago, and we have confidence in advocating for them the introduction of what may be called "rural certificates" carrying the privilege of acceptance at Treasuries in payment of taxes, and of re-issue under certain conditions. This again is not without modern precedent. The 5 per cent War Loan in England can be tendered in payment of Death and Inheritance Duties, and in France also certain government issues carry the same privilege.

Frequent Changes in Rate of Bonus Undesirable.—Before we bring to a close our remarks with regard to Cash Certificates, a protest must be registered against the frequency with which alterations are made in the rates at which the existing Cash Certificates are issued. The rate of yield on them was decreased once in 1926 and again in the following year. Now it is perfectly clear that the movement is in a nascent stage, and it is highly undesirable that rates should be

[1] Fisk: "English Public Finance," p. 99.

frequently tampered with. Various reasons may be assigned for such changes, however, which may be considered here.

One argument is, that the rate of interest at which the new borrowings of the government take place has gone down. Is the argument really tenable? The 1929 long-term rupee loan gave an effective yield of 5·459 per cent, the cash certificate rate then was $4\frac{1}{2}$ per cent. In the year 1930, 6 per cent Bonds repayable in 1933—36 have been issued, the cash certificate rate at the time was $5\frac{1}{4}$ per cent. Rates for sterling loans, as we have shown elsewhere, are still higher. Are these rates not definitely higher than 5 per cent? Why then should only $4\frac{1}{2}$ or $5\frac{1}{4}$ per cent interest be allowed on the savings of the small investor who employs Cash Certificates as his medium?

"The essence of the scheme," according to the Controller of Currency,[1] "is that the amounts lent to the government are repaid after five years with *a bonus calculated to yield compound interest at a rate somewhat higher than the current rate of government borrowings in India.*" When

[1] Referring to Cash Certificates in his Annual Report on the Currency Operations of the Government of India, for the year 1923-24.

the essence of the scheme, as the Controller of Currency would call it, was departed from by making two heavy reductions in the rate of interest in consecutive years, it is not at all surprising that the total issues of such certificates distinctly fell in the two years 1927-28 and 1928-29 from the summit they had reached in 1925-26.[1] "The decrease in the receipts in the last two years," wrote the Controller of Currency in his Report for 1928-29,[2] "was due to the reduction in the yield on the 1st July 1927, from $5\frac{1}{4}$ per cent free of tax to $4\frac{1}{2}$ per cent free of tax." This is certainly not enough to pay the small investor a rate a little higher than the one at which the government borrows fresh loans. We would argue strongly that the small investor

[1] Cash Certificate Issues, 1925—30 :

	(Rs. crores)
1925-26	9 55
1926-27	7·53
1927-28	6·09
1928-29	4·91
1929-30	7·15

The increase in the year 1929-30 is due to the restoration of the rate of interest on Cash Certificates to $5\frac{1}{4}$ per cent since July 1929. As we go to press, a Finance Department notification announces a further increase in the rate of interest on cash certificates to 6 per cent with effect from September 15th, 1930.

[2] Para 33 relating to the transactions in connection with Post Office Cash Certificates.

in cash certificates should be allowed at least as high a rate as the highest which the government is at present paying on any other existing loans. The small investor is entitled to receive from the Treasury the same rate as that being paid to the big investor. The present position is, that up to 1936 the Government of India will continue to pay 6 per cent compound interest on certain loans ; up to 1955, 5 per cent and up to 1970, 4 per cent. This takes into account only the loans raised by the central government, without considering the $6\frac{1}{2}$ per cent and 6 per cent loans raised by the provinces and the municipal corporations, or the recent sterling issues of the Government of India on which the flat and the redemption rate works out at more than 5 per cent, sometimes even up to about 7 per cent. It does not therefore appear to be fair that up to 1955 (the final date of repayment of the 5 per cent long-term loan), the cash certificate-holder should be paid anything less than 5 per cent compound interest. The actual yields on the regular short- and long-term 5, $4\frac{1}{2}$ and 4 per cent loans are much higher, as these have been issued at discounts which make them very attractive. It is on similar considerations that we have suggested above the grant of 5 and 10 per cent

premiums to the holder of cash certificates, if he agrees to forego the right of withdrawing money for the next ten and fifteen years respectively. The object is to extend the system of "Deferred Investment."

Rate of Interest Ought to be Revised.[1]— There is yet another aspect from which the question of the rate of interest allowed on cash certificates may be considered. What is the rate at which the Government of India lends money to its various constituents: the Provinces, the Native States, the Municipal Corporations, and others? If it is 5 per cent, then let the government grant to its youngest and promising financial child the rate which it charges others, without deducting any middlemen's commission. Sir George Schuster stated in his Budget Speech in 1929,[2] that the rate of interest paid by the commercial departments was 5·43 per cent in

[1] This chapter was written early in 1929 when the rate of bonus on cash certificates was $4\frac{1}{2}$ per cent. The last two increases in the rate, one in July 1929, and another in September 1930, following the issue of direct loans at a higher rate, have anticipated our argument. That, however, proves that the Government has shown a tendency to treat the cash certificate system as a subordinate branch of the Government's direct borrowing operations, and not to develop it on independent lines.

[2] Para 11.

1926-27, and 5·38 per cent in 1927-28, and was expected to be 5·32 per cent for 1929-30. Thus a higher rate than $5\frac{1}{4}$ per cent could in fairness be allowed to cash certificate-holders. Even on Provident Funds mostly belonging to higher services, the rate of interest allowed is 5 per cent.[1]

And finally, there are numerous provincial and local bodies that are carrying debts at a higher rate than the 5 per cent compound rate of interest. They would be only too glad if they could get money for the conversion of those loans even at 5 per cent. It appears hardly reasonable that on the one hand, the provincial and local bodies[2] should continue to pay 6 or $6\frac{1}{2}$ per cent compound interest on their existing obligations, and the Central Government should borrow in England at over 6 per cent, while on the other hand the latter should neglect to use resources which may yield larger amounts, if only

[1] See p. 203.

[2] According to the 1927-28 Report of the Municipal Commissioner for the City of Bombay (page 96), loans of the Corporation amounting to $8\frac{1}{2}$ crores bear interest between $5\frac{1}{2}$ and $6\frac{1}{2}$ per cent. According to the Stock Exchange Year Book for 1930 (page 2266), Calcutta Port Trust Debentures repayable in 1931-51 bear 7 per cent rate of interest. Also several Improvement Trust Loans of Calcutta bear 6 and $6\frac{1}{2}$ per cent rate of interest (Stock Exchange Year Book, 1930, p. 2265).

a moderately high rate of interest is maintained in order to tap them. The neglect of these resources is the more indefensible as the Government of India has to renew in the next seven years a debt of over 200 crores of rupees in addition to its requirements for financing its year-to-year programme of new capital. And it must be mentioned in passing, that the rate of interest on the best capital issues in London has not yet (May 1930) fallen below 5 per cent.

Objections to Higher Yield Certificates Answered.—A frequent complaint of course against the issue of cash certificates at a high rate of yield is that they compete with bank deposits.[1] It must be acknowledged, in all fairness, that in certain cases a banker must find it difficult to compete successfully with the cash certificate rate. But the question must be looked at as a whole. The government annually requires, let us say, 40 crores of rupees. The larger the amount that it can raise by means of cash certificates, savings banks, and provident funds, the smaller is the balance for which it will be required to go to the open money market. Which

[1] *E.g.* Budget Statement, 1926-27, para 39.

is the greater evil? To raise money by means of cash certificates and other indirect methods which may, to a certain extent, tap sources which can never be available to a private banker, or to disturb the money market by a large loan? Few people will dispute the advantage of the discontinuance of the practice of making annual borrowings in the open money market if the needs of the government can be otherwise met.

It is a sound principle of public finance that popular loans ought to be few, and yet we find that the Government of India is an annual open market borrower. For three years from 1925 to 1928 the borrowing operations in the open money market mostly consisted of conversions. The Government took very little new money from the money market, and satisfied its needs from other sources, the loan debt standing at 370 crores in 1925 and at 372 crores in March 1928. The result was that the bank discount rate during this interval did not rise above 7 per cent, a fact in which the Finance Member took a legitimate and pardonable pride in his Budget Speech of 1928. On the other hand, in the period before and after this interval, the discount rate has been up to a much higher figure when the money market has been disturbed by the withdrawal

of money on government account. We shall revert to the subject again at a later stage. Suffice it to say for our present argument that, granting the fact that the government takes a certain amount of money annually, it is much better that it should take it from a much wider area, even at a higher rate of interest, than that it should have to take it from a handful of bankers and businessmen on whose funds there are so many calls, and who in the present circumstances of the government's continuous annual borrowings begin to look forward to the appearance of such investments, and may even sometimes become a little unmindful of trade interests.

A third point raised against cash certificates is, that they are a tax-exempt form of security. But while one may believe that government securities are a perfectly legitimate taxable asset, the argument should not be allowed to become a fetish. What is the position after all with regard to the existing debt? A major portion of it is tax-free: the whole of the external debt in particular is free from the assessment of Indian income-tax; almost all the war and post-war loans up to 1926 were tax-exempted issues; cash certificates and provident funds pay no income-tax; depositors in savings banks with small amounts to their credit

would hardly be paying any income-tax on their small interest-yields; there can be no question of an income-tax on Treasury Bills in the Paper Currency Reserve. Then there may be persons whose holdings of government securities are so small as not to yield incomes sufficient to make them minimum taxable assets, even in conjunction with other sources of income. And finally, there are those who are wise enough to deposit their securities with the Accountant-General, and who thereby avoid the payment of income-tax up to a holding of 22,000 rupees.

In these circumstances, cash certificate-holders are not to be regarded as specially fortunate people in their enjoyment of the privilege of tax-exemption of their holdings. The greater part of the debt indeed is so held today. Then again, the income-tax of the Central Government is not the only tax to which an income under this head may be subject. Some District Boards in the United Provinces have introduced what is called a "Circumstances and Property" tax. If they know that a person enjoys an income from cash certificates, there is nothing to prevent them from assessing that part of his income for a tax. So far as the small investor is concerned, therefore, the first step is to allow the taxable assets to

be created before one can begin to impose a tax. Eggs cannot be hatched before they are laid! Moreover, rural communities all over the world fight shy of direct taxes on income. France formulated a policy of income-tax just before the war, but she could not carry it through during the war for fear of popular opposition. Most of her war and post-war loans were issued tax-free. When an attempt was made to impose a tax on securities, the *rentier* sent them abroad, or invested in foreign securities. In the United States of America, the exemption of securities from taxation has been the price paid in almost all government loans to a greater or smaller extent in order to make them sufficiently attractive and absorbent of small savings. We have no wish to defend the French system, which has resulted in shutting off from the State an important taxable asset in the form of State Bonds. A discussion of the evils of tax-exempt securities,[1] on the grounds on which they have been defended (particularly by American economists), would lead us too far from our immediate

[1] A comparison of the quotations of 5 per cent tax-free and non-tax-free rupee securities would show that the former pass at artificially high values owing to their keen demand among the richer classes (see p. 61).

subject. The essence of our argument here is that the small investor should, for the time being, be left free, up to a point, to gain his experience in the art of investing in government securities without the fear of being liable to taxation, a liability which he can obviously avoid if he invests his money elsewhere.

Lastly, there is the argument that some changes have also taken place in England in the price of issue of Savings Certificates. The rate of interest on Savings Certificates in England held for a number of years works out at $4\frac{1}{2}$ per cent. Post offices allow $2\frac{1}{2}$ per cent interest on deposits, and banks a rate which is usually 2 per cent below Bank rate. An average deposit rate is about 2 to $2\frac{1}{2}$ per cent,[1] and may be less, but there is a margin of at least 2 per cent between the bank deposit rate and the one offered on Savings Certificates. England, moreover, is an international centre for capital issues. The conditions of the money market there are entirely dissimilar to those obtaining in India. The slightest mistake in fixing the rate of interest on any particular form of investment in England, and particularly

[1] In exceptional periods it may be much lower, *e.g.* in Britain since Bank rate has fallen to 3 per cent bank deposits yield only 1 per cent.

one enjoying the privilege of tax-exemption, is bound to divert money from other directions. Considering all the circumstances, however, the rate of interest on Savings Certificates in England is sufficiently high. The conditions of their issue, on the other hand, are very rigid. Such certificates, moreover, being almost the only tax-exempt securities in that country, are viewed with a very great amount of jealousy. Abolish the rule of the maximum individual holding, and you would find a large portion of the public debt of Great Britain converted into Savings Certificates held by wealthy Englishmen and Americans. For such reasons as these, there is absolutely no parallel between the highly-developed conditions of the money market of the United Kingdom, where there is competition among the banks to serve the banking needs of the population, and the ill-developed money market in India, where the slackest season in the market may be contemporaneous with a very heavy rate of interest on loans and advances in the rural areas.

Provision for Accrued Liability.—In conclusion, let us discuss one more aspect of the Cash Certificates system that has exercised the

minds of our Finance Ministers during the last three years, namely, the question of provision for the accrued unpaid bonus liability. As the Indian Budget is prepared on a cash basis, provision for interest payment is made only for certificates estimated as likely to be actually presented during a particular year, and not for the full amount of interest payable annually on the total holding, with the result that during the last few years, much smaller amounts of money than are actually due for interest have been paid, and a heavy sum has accumulated as arrears of interest liability. Sir George Schuster calculated the following figures for 1926-27, 1927-28 and 1928-29[1]:

Year	Average funds held in cash certificates	Amount of bonus paid	Effective rate of interest
1926-27	23·82 crores	16 lakhs	2/3 per cent
1927-28	28 69 "	23 "	4/5 per cent
1928-29	31·50 "	60 "	2 per cent

The arrears of interest accumulated in the above fashion were estimated to amount to some $7\frac{1}{4}$ crores of rupees in September 1929.[2]

[1] Budget Statement for 1929, para. 28.

[2] Budget Memorandum, 1929.

On a simple basis of $5\frac{1}{4}$ per cent interest, the liability in respect of cash certificates—the present cash certificates holding being 35 crores—would amount to about 1·88 crores of rupees annually, and at 6 per cent, the new rate, to a still larger amount. We are not concerned with the revenue aspect of the question,[1] but from the point of view of debt administration, matters would be considerably simplified if all the amounts due from the Government of India as interest under that head were annually paid to the National Investment Board, the establishment of which we propose, a body to which we would entrust the management and investment of all reserve, suspense, endowment, trust and other funds unaccounted for.

Other Post Office Facilities.—The remaining two groups of facilities existing for the small investor, namely, the occasional issue of regular government loans through the post office, and the purchase, sale and custody of government paper on behalf of certain investors by the

[1] Arrears of interest have been included in the debt and for future, Post Office Cash Certificate Bonus Fund has been set up to which balance of interest of the year after actual payment will be transferred in future—*Vide* Finance Secretary's Budget Memorandum for 1930, para 38.

Accountant-General of Posts and Telegraphs may be briefly dealt with:

Regular government loans through the post office originated in the following manner: When the London money market insisted on being relieved from external issues during the war and it became urgent for the Government of India to find money for its requirements from its own market, it adopted various devices in order to raise money in the country, and one of them was the system of inviting subscriptions through the post offices. The practice first began with the loan raised in the year 1915. The postal section of the loan raised was usually kept open for the receipt of subscriptions for a much longer period of time than the main section. Thus, in the case of the first war loan (1917), while the main section of the loan was closed after three months, the postal section remained working for seven months. Investors under this section, moreover, were allowed to subscribe in much smaller amounts than they could do under the main loans. In the case of the first war loan, for instance, while the minimum subscription to the main section of the loan was 100 rupees, one could take up a minimum paper of 25 rupees through a post office. After

the war, however, these postal facilities were withdrawn one by one until in the year 1924, subscriptions through the post offices were stopped altogether. The total proceeds of the loans and the amounts raised through the postal sections during the period of their existence, are shown in the Statement which follows:

INDIAN RUPEE LOANS: TOTAL PROCEEDS AND POSTAL SECTION SUBSCRIPTIONS, 1915—1924[1]

(In crores of rupees)

Year	Total loan raised	Proceeds of postal section
1915-16	$4\frac{1}{2}$	·50
1916-17	6·7	·33
1917-18	39·7	4·3
1918-19	57	5·5
1919-20	21	·61
1920-21	30	·94
1921-22	49	·92
1922-23	47	1·05
1923-24	24	·04

[1] Taken from the Memoranda of the Secretary or Under-Secretary of State for India.

We find that in three particular years, namely, 1917-18, 1918-19 and 1922-23, substantial amounts of money were raised through the postal loan section. The success of this section in the year 1917-18 was due to the issue of 3 and 5-year bonds bearing interest at 5½ per cent. Owing to their short-term nature and very high yield, those bonds were very much patronized. Their success in the following year was due to their being issued at 5½ per cent, tax-free, this time for 3, 5, 7 and 10 years' currency, the last two being repayable at 103 and 105 respectively. And again in the year 1922-23, it was the same causes, namely, the high yield and the short-term nature of the bonds, which made the postal section popular. This time 5 and 10-year tax-free bonds were issued at 6 per cent.

When, however, the yield from cash certificates was raised to about 6 per cent in 1923, money that would have been invested in the postal section of the regular government loans began to be diverted to them. Thus, while the postal section of the regular loan of 1923-24 yielded only four lakhs of rupees, cash certificates in that year yielded 6·91 crores and the savings banks 1·59 crores of rupees. The following table, showing the total amounts of

money received by various methods through the Post Office, reveals some interesting points:

SUBSCRIPTIONS RECEIVED THROUGH THE POST OFFICE, 1915—30 [1]

(*In lakhs of rupees*)

Year		Proceeds of regular loans	Cash Certificates issued	Additions to Savings Banks deposits in the year
1915-16	...	50	...	43
1916-17	...	33	...	127
1917-18	...	430	1,000	—2
1918-19	...	550	443 [2]	224
1919-20	...	61		252
1920-21	...	94	100 [3]	152
1921-22	...	92		—60
1922-23	...	105	70	94
1923-24	...	4	691	159
1924-25	...	...	610	85
1925-26	...	...	955	159
1926-27	...	...	753	227
1927-28	...	...	609	315
1928-29	...	...	491	182
1929-30	...	...	715	299

We have already said a great deal about the cash certificates. They were very much

[1] The figures of loan proceeds are taken from the Parliamentary Memoranda on "Accounts and Estimates", of Cash Certificates issued from the Reports of the Controller of Currency, and the additions to the savings bank deposits from the appendices of Financial Statements.

[2] This is the combined amount for 1918-19 and 1919-20.

[3] This is the combined amount for 1920-21 and 1921-22.

favoured in the first year of their issue (1917-18), and again from 1923 onwards when the yield from them was made distinctly better than that from any other form of government security. Even the proceeds of the Postal Savings Bank system fared better than those of regular government loans in certain years.

It can be distinctly observed that in two periods—first, for a group of years before 1923 (1918-19, 1919-20 and 1920-21), and again since 1926 (1926-27, 1927-28 and 1928-29)—when the difference between the rate of interest on savings bank deposits and the yield on cash certificates was much smaller, the former showed a tendency to swell to appreciable figures and to hold its own against the latter.

The popularity of Post Office savings bank and cash certificates may be assigned to two causes. Firstly, cash certificates and Savings bank facilities remain available all the year round. And secondly, in both these forms the money remains available at call to the investor. But since the investor has shown an equally high preference for the short-term bonds in which money is also locked up for short intervals, we advocate the adoption of what we have called Cash Bonds. This proposal

has already been fully set out in the section on Cash Certificates; but, in general, it is here argued that short-term bonds should regularly remain on tap in certain weeks of the year, though in Presidency-towns and a few other big banking and commercial centres, some restrictions on their issue may be desirable.

The Custody of Government Paper with the Accountant-General.—When regular loans are not open to subscription, an investor anxious to buy government securities can do so through the Post Office. The Accountant-General will purchase securities for any applicant, at the market rate, and will also sell them for the holder at the market rate. Such purchases can be made up to a limit of 5,000 rupees annually, and of 22,000 rupees in all.[1] But the most important point about this facility is that securities purchased thus or otherwise can be lodged with the Accountant-General for safe custody, and up to a maximum holding of 22,000 rupees, income-tax will not be levied on the interest-income.

This latter maximum, it is to be noted, takes no account of any already tax-exempt securities

[1] *Vide* "The Guide Book for Investors in Government of India Securities," 1921 edition.

that the investor may care to deposit similarly with the Accountant-General of Posts and Telegraphs: a rule which appears to be very illogical in two respects. In the first place, while the total amount of Cash Certificate holding, which is also tax-exempt, is only 10,000 rupees, this rule permits of a tax-exempt holding, provided it is in the form of other securities, of 22,000 rupees. As we have already advocated, therefore, the limit imposed on Cash Certificate holding should be gradually raised to 40,000 rupees, subject to the condition that not more than 5,000 rupees can be withdrawn in any one year. The second point is also with regard to the maximum holding. The present maximum holding of tax-bearing securities—Rs. 22,000—was based on the idea of 1,000 rupees being the minimum taxable income. Since the limit of exemption is now 2,000 rupees, however, the maximum might usefully remain at this figure for private individuals but be doubled as the special privilege of certain particular institutions and in certain special individual cases, e.g., minors.

We have devoted a good deal of space to the problems of the small investor. But our justification is that this movement for utilizing the savings of the small investor has made very rapid

strides in Britain and America during the last few years through various types of institutions. It was stated recently by the Rt. Hon. Walter Runciman at the annual meeting of the United Kingdom Provident Institution, that the number of small investors has increased enormously in Britain during and since the war, and that the immense sum of nearly £2,000 million is held by them "visibly and beyond all doubt" in the various forms of Building Societies, Insurance Institutions, Trustee Savings Banks, Friendly Societies, and finally, the National Savings Movement. The Trustee Savings Banks and some other institutions organized a session of the International Thrift Congress in London in October 1929, with a view to promoting the thrift movement on the part of the small investor. The first, third and fourth of the list quoted have no Indian counterparts; the second is not very popular, and has not made much headway. Our chief reliance must therefore be placed on the use of public credit through the Postal Cash Certificate and the Savings Bank systems, to "tap" and mobilize the savings, large in total though individually small, of India's scattered rural communities, and to draw them into productive channels.

CHAPTER VI

THE DEVELOPMENT OF THE MONEY MARKET IN INDIA

THE title given to this chapter admits of a much wider scope than the matter which can reasonably be included within the scope of a discussion of the use of public credit. The development of Money Market organization in a country depends upon a variety of factors—the growth of an industrial civilization, the amount of progress in the investing habits of the population, the extent of the banking net-work, the development of other financial institutions, and the general organization of Stock Exchange facilities. India is deficient in some, and entirely lacking in certain others, of the factors which tend to bring about the adjustment of the potential supply of capital to the demand for it, for the various requirements of the country. Public borrowing, although only one of the important factors which influence the development of the Money Market, can none the less, in the special conditions obtaining in

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India, play a very conspicuous rôle in effectually mobilizing the capital resources of the country.

Borrowing Difficulties of Indian Government.—Let us frankly recognize at the outset that the borrowing policy and programme of the Government of India places it continuously in a peculiarly embarrassing position. If the Government holds up its capital programme and suspends borrowing, it is charged with bankruptcy. If it raises a loan in London, a high price has to be paid, and sterling obligations are increased. If the Government offers a long-term loan in India, however, the yield is very small; if short-term loans are raised, they prove embarrassing as regards repayment or conversion at the time of maturity. If it borrows in the open market, money comes from commercial centres, and trade and industry suffer as a result of financial stringency; if it offers a high price to attract money from the small investor, such as the holder of Cash Certificates, the banks complain of competition. If low rates of interest are offered in India, loans are not successful, and the danger arises of capital being exported abroad by private investors permanently and by bankers and businessmen for short intervals to places where

higher yields are obtained. On the other hand, if attractive terms are offered, they are likely to bring about a "clean sweep" of funds, deflation of the currency, stringency in the money market and high bank rate, difficulties in the way of transfer of funds to London where the greater portion of the capital expenditure is incurred, and finally, a weakening of exchange. How are we to get out of this apparent *impasse* ?

Into the general question of whether the State should directly undertake capital expenditure or not, we do not at this stage feel ourselves competent to enter. For good or evil--perhaps more for the former than for the latter, but beyond dispute as a question of fact—under the present circumstances, it has, in India, fallen to the lot of the Government, instead of being left to the initiative of private enterprise, as is the case in most other countries, to formulate, finance and execute large programmes of capital expenditure on various kinds of public utility services. The State in India annually requires large amounts of capital for the extension of the country's railway and telegraph systems ; for the improvement of harbours, the development of irrigation and navigation works; for the metalling of roads and construction of bridges; for the generation of

hydro-electric energy and the exploitation of India's forest wealth; and, finally, for advances to local bodies, Native States, the agricultural and land-owning classes, and many other deserving individuals and institutions. Whether the money for all this State-executed development of the resources of the country should be found out of the savings of the indigenous community, rather than be supplied from external agencies, is a question which from one point of view at least we can safely answer in the affirmative. From the standpoint of public finance, the substitution of an internal for an external debt is desirable on economic as well as political grounds. "A foreign debt," as E. M. Friedman has said in his book "International Finance and Its Organization,"[1] "requires annual interest payments, which may be effected by an exportation of goods, and to that extent the debt represents a diminution of the real wealth of a country, but an internal debt is a paper debt; it does not diminish the wealth of a nation as a whole." The large proportion of external debt now owed by us, involves, in the words of Sir Basil Blackett, "a drain on India's production of goods

[1] P. 22.

and services in the future up to the value of the principal, together with the future further drain of these goods and services for interest during the interval until the principal is paid for."[1] The repayment of these external obligations, and the avoidance of them in future, would therefore mean a great addition to the net national wealth of the country.

Indian Capital Resources.—The question that next suggests itself to us is: Have we sufficient resources to liquidate our past capital obligations and to meet those of the future? Capital is created from the savings out of the profits of agriculture, industry and trade. Savings are, as it were, the result of social surplus—a social surplus which is the difference between the goods consumed in maintaining life and the total wealth produced by industry. This surplus, again, may be appropriated by taxation, or invested directly in productive industry, or hoarded.

Are there enough past hoards or present savings in India to ensure a regular flow of capital? A detailed discussion of all the factors

[1] Legislative Assembly Proceedings: February 17th, 1925, p. 1146.

bearing on the determination of the social surplus in India would take us too far afield. It suffices for our present purpose to concern ourselves with one of the most important unused resources that can be profitably tapped with a view to making public borrowings more successful in this country.

We give below a table indicating the excess of exports over imports, and the net imports of bullion into India from 1914 to 1928:

NET EXPORTS OF COMMODITIES AND NET IMPORTS OF BULLION, 1914—1928[1]

(*In crores of rupees*)

Year		Balance of exports over imports	Net imports of bullion
1914-15	...	37·24	16·51
1915-16	...	61·31	3·72
1916-17	...	87·12	32·03
1917-18	...	80·54	44·22
1918-19	...	66·74	62·35
1919-20	...	114·32	64·55
1920-21	...	−79·80	8·59
1921-22	...	−33·94	12·23
1922-23	...	69·88	59·54
1923-24	...	126·19	47·88
1924-25	...	146·87	94·00
1925-26	...	150·81	51·97
1926-27	...	70·13	39·26
1927-28	...	59·70	28·32
Total	...	957·11	565·17

[1] Compiled from the appendices of the Explanatory Memoranda of the Secretary or Under-Secretary of State for India.

India has exported goods worth 957·11 crores of rupees more than she has imported during the period considered. A considerable portion of this amount has no doubt been counter-balanced by payments to the Secretary of State for India in connection with what are called the Home Charges (among which the heaviest single item is the payment of interest on the sterling debt, which now amounts to over £13 million annually), and other 'invisible imports' such as the shipping, banking and insurance charges, home remittances of British officers in India, and of the profits of industry and trade made by their non-official compeers. But we find also that more than half of the total difference has been liquidated by means of the direct import of gold and silver.

The irony of the situation is in the net result—the import of precious metals amounting to 565 crores of rupees on the one hand, and the increase in the sterling debt obligations of the State amounting to £167 million (or about 250 crores of rupees) over the same period, on the other. The Bank of England supports the huge superstructure of British credit with a total normal stock of gold averaging £150 million (the figure recommended by the Cunliffe Committee),

which very often falls below this amount. The total gold holding of the Bank of France amounted at the end of 1929 to £336 million, a figure which, in the authoritative opinion of Prof. Cassel,[1] is to be regarded as too high an amount for France's currency requirements. India's war and post-war accumulations of gold and silver amount to 565 crores of rupees (£424 million), in addition to her large scale absorption of the yellow and white metals before the war. Only just recently, attention was drawn to the problem by the Viceroy on the occasion of the opening of the Federation of Indian Chambers of Commerce at Delhi.[2] He pointed out that India had imported £400 million worth of gold and £350 million worth of silver since 1900, and was still importing gold at the rate of about £15 million, and silver at about £7·5 million annually. Nobody can admit for a moment that India's currency requirements justify such large imports of bullion on the ground of increased production or extended trade activity. The fact rather is that India's foreign trade has only recently recovered to its pre-war level. Here is, then, an immobilized asset, yet

[1] In a recent number of *Barclay's Bank Review*.
[2] February 14th, 1930.

one which, if properly dealt with, could be turned to fruitful uses. If the country made up its mind to convert its huge uneconomic supplies of the precious metals into more iron and steel, building and structural materials, machinery, plant, rolling stock, and other such requisites for the development of her industrial wealth, and received gold and silver only in accordance with her normal trade requirements, the repayment of the external debt could well be arranged within a measurably short period of time.

Annual Requirements of Public Bodies.—What are the annual requirements of public bodies in India? The total sum needed annually by the Central and the Provincial Governments has been put by Sir Basil Blackett,[1] at 40 crores of rupees. This, however, was in 1925, and allowing for the increase of the rupee and sterling debt, from 1914 to 1928—in respect of the war contribution, budget deficits, railway purchases, new programmes of construction and provincial expenditure—the average

[1] In a speech in connection with a debate on the "Debt Position of India," on February 17th, 1925, when he was Finance Member in the Government.

debt requirement works out at about 44 crores of rupees annually over a period of 14 years. If we take 30 crores to be the annual capital requirements of the Central Government (a liberal figure for railway expenditure, recommended by the Acworth Committee and endorsed later by the Railway Finance Requirements Committee of 1923), 10 crores of rupees annually for the provinces (this being the provincial average for the seven years from 1921 to 1928), and allow another 15 crores of rupees for the redemption of the external debt with the object of extinguishing it completely in a period of about 30 years, we arrive at the figure of 55 crores of rupees annually. (Local bodies of course will require an additional sum, say 5 crores of rupees.) The problem then is to find a sum of about this size from internal resources, without injuring the legitimate interests of trade and industry.

It may be recalled that the pre-war average increase (from 1900 to 1914) in the rupee debt, including direct loans as well as other sources, amounted only to about 5 crores of rupees annually. When the Mackay Committee considered the problem of Railway finance in 1908, it estimated the total capital yield from local resources, including rupee loans, savings bank deposits, and budget

surpluses, at £5 million annually,[1] and, "previous to the war, the maximum amount raised in any year by rupee loans in recent years was $4\frac{1}{2}$ crores in 1906."[2] Witness after witness before the Chamberlain Currency Commission (1913) thought that if more facilities were given, the money market in India could yield another crore or two. Mr. Howard of the Currency Department, for instance, believed that the Government could have tried for four crores of rupees instead of three, though he did not "think we could put a loan of 6 crores of rupees on the market and hope that we could get it taken up. We are mainly dependent on the banks, though there have been occasions on which other gentlemen have taken considerable interest in the loans. The policy was to place as much as possible in India."[3] The popularity of Government Paper was very much restricted in the pre-war period. "We are informed," wrote the Railway Committee (1921),[4] "that before the war, Government rupee loans were taken 'firm' by the three

[1] Cmd., 4111, 1908, para 16.

[2] "Guide Book for Investors in Government of India Securities," p. 13.

[3] Chamberlain Commission Evidence, Vol. I, Q. Nos. 8200-01.

[4] Cmd., 1512, 1921, para 246.

Presidency Banks, and that these banks subsequently disposed of their holdings to the public." Yet we find that in the war and post-war period, the Indian money market showed great potentialities for further development. From 1917, when the first intensive campaign for the fuller utilization of local resources was carried on, to 1928, an interval during which the Indian market yielded unprecedentedly large amounts of money, the average increase of the rupee debt was 32 crores of rupees annually. How is the extraordinary success of war and post-war public capital issues in India to be explained ?

SUCCESS OF WAR AND POST-WAR RUPEE BORROWINGS

Co-operation of Banks.—A number of causes combined to bring about a healthy financial outlook for the success of Government loans in the Indian money market in the war and post-war years. One of the most important of them was a much closer co-operation in financial matters between the Government and the premier banking institutions in the country. This co-operation has been of a

two-sided character: (a) in respect of the facilities given by the Government to the banks, and (b) in the help accorded by the banks to the Government in its financial operations.

(a) The former took three forms: (i) the placing of larger Government balances, at the disposal of banks, (ii) the issue of additional paper currency against securities, and (iii) provision for an issue of emergency paper currency in times of tightness of the money market.

(b) The banks rendered help to the Government among other ways by the following in particular: (i) A sound system of Ways and Means advances has been developed; (ii) in addition to aiding in large measure the raising of ordinary loans, the banks have purchased a major share of the Government's short-term paper in the form of Treasury Bills; (iii) the co-ordination of the resources of the three Presidency Banks, and the subsequent spread of a net-work of branches of the Imperial Bank of India, have meant greater financial strength and stability; (iv) on certain occasions the Imperial Bank of India has given facilities to subscribers to Government loans in the shape of advances from its funds for short intervals. We shall now deal with all these aspects one by one:

Larger Government Balances with Banks.—On the next page is given a table showing the maximum and minimum rates of discount prevailing, with the maximum and minimum amounts of Government balances left annually, formerly with the Presidency Banks, and later, on its incorporation, with the Imperial Bank of India. The amounts are given in crores of rupees.

Certain facts emerge from this table. In the first place, the Government now keeps larger balances with the banks than before the war. Secondly, maximum Government balances in the banks and minimum Bank-rate of discount have, generally, occurred at the same periods. (The months in which this has happened are given in the table in italics.) Thirdly, there is a certain correspondence, also, between the minimum Government balances and the maximum Bank-rate, although the Government bank balances have reached their minimum more often round about November than about February or March, when the Bank-rate has usually been at its highest. Finally, the minimum discount rate during the war and post-war period has never fallen to the pre-war low level of 3 per cent.

The average for the pre-war quinquennium, ending in the year 1913-14, of the maximum

GOVERNMENT BALANCES AND DISCOUNT RATES, 1900—1930 [1]

Year	Maximum Government balance (in crores of rupees)	Minimum bank discount rate per cent	Minimum Government balance (in crores of rupees)	Maximum bandkiscount rate per cent
1900-01	3·31 (Jan.)	3 (July)	2·59 (Nov.)	8 (Mar.)
1901-02	3·38 (*June*)	3 (*July*)	2·93 (*Mar.*)	8 (*Mar.*)
1902-03	3·60 (Dec.)	3 (July)	3·06 (Oct.)	8 (Mar.)
1903-04	3·52 (April)	3 (Aug.)	3·03 (*Feb.*)	7 (*Feb.*)
1904-05	3·84 (*Sept.*)	3 (*Sep.*)	3·00 (*Jan.*)	8 (*Mar.*)
1905-06	3·82 (*May*)	3 (*July*)	2·84 (Nov.)	9 (Feb.)
1906-07	3·68 (*August*)	3 (*July*)	2·95 (Oct.)	9 (Feb.)
1907-08	4·10 (Mar.)	3 (July)	2·86 (*April*)	9 (*April*)
1908-09	4·19 (*July*)	3 (*July*)	3·04 (*Jan.*)	8 (*Jan.*)
1909-10	4·58 (*July*)	3 (*July*)	3·07 (*April*)	7 (*April*)
1910-11	4·10 (*Sept.*)	3 (*Sep.*)	3·53 (June)	8 (Mar.)
1911-12	4·48 (Nov.)	3 (Aug.)	3·68 (*Feb.*)	8 (*Feb.*)
1912-13	5·65 (Mar.)	3 (July)	4·00 (April)	8 (Feb.)
1913-14	6·18 (*Oct.*)	3 (*July*)	4·85 (May)	7 (Mar.)
1914-15	10·12 (*Aug.*)	3 (*Aug.*)	4·84 (*Nov.*)	6 (*Nov.*)
1915-16	8·87 (*Aug.*)	5 (*Aug.*)	4·42 (Nov.)	8 (Mar.)
1916-17	10·11 (Mar.)	5 (July)	4·84 (May)	8 (Feb.)
1917-18	22·65 (*June*)	5 (*Sep.*)	7·37 (Nov.)	6 (Mar.)
1918-19	18·60 (*Sept.*)	5 (*Sep.*)	6·54 (April)	7 (Mar.)
1919-20	18·26 (Feb.)	5 (July)	7·04 (Sept.)	7 (Mar.)
1920-21	20·38 (*July*)	5 (*July*)	5·84 (*Feb.*)	7 (*Feb.*)
1921-22	25·87 (*July*)	5 (*July*)	5·34 (Nov.)	8 (Mar.)
1922-23	33·19 (*July*)	4 (*July*)	8·22 (Nov.)	8 (Mar.)
1923-24	29·74 (*July*)	4 (*July*)	6·22 (Nov.)	9 (Feb.)
1924-25	32·18 (*July*)	4 (*July*)	7·42 (Dec.)	9 (April)
1925-26	28·96 (*May*)	4 (*July*)	4·29 (Dec.)	7 (April)
1926-27	36·41 (*July*)	4 (*July*)	3·85 (Dec.)	7 (Mar.)
1927-28	19·97 (April)	4 (July)	3·05 (Oct.)	7 (Mar.)
1928-29	17·20 (*Aug.*)	5 (*Aug.*)	3·71 (April)	8 (Feb.)
1929-30	20·65 (*June 28th*)	5 (*July*)	5·88 (June 7th)	8 (April)

[1] Compiled from the appendices of the Financial Statements.

Government balances in the Presidency Banks was 5 crores of rupees annually, and the average of the minima, 4 crores of rupees. For the eleven years from 1917-18 to 1927-28, on the other hand, the average for maximum and minimum balances works out at 26 crores and 6 crores of rupees respectively. Although the very high level of public deposits in the banks in the second half of the year, that is so striking a feature of the war and post-war monetary conditions, is rather the result than the cause of the success of the heavier public borrowings of recent years, the general policy of leaving as much Government money for as long an interval of time as possible in the banks, is in the general interests of trade, and serves to maintain the chances of successful public issues. Loud complaints were made before the Chamberlain Commission that banks could take up larger quantities of Government Paper if they were only assisted with Government balances in time of need, to wit, the busy trade season of the year. "In any case," wrote the Commission,[1] "those who are qualified to speak on behalf of the Indian banking community are all agreed in stating that larger loans could be

[1] Para 168.

issued each summer in India, if some means were available for counteracting the stringency that recurs annually in the winter and early spring. The practice of making loans from the Paper Currency Reserve and from balances, will certainly assist the Government in increasing their annual rupee loans in the summer. The banks would probably be glad to keep larger holdings of Government stocks, if, by so doing, they did not run the risk of having insufficient liquid resources in the busy season." The principle of utilizing Government balances, with due regard for public, as well as business, requirements, has of late been greatly extended by the incorporation of the Imperial Bank of India, the abolition of reserve treasuries, and the transfer of funds from this source, and from the treasuries at places where there are branches of the Imperial Bank of India, to the care of the latter. But several crores of rupees still remain locked up in the 1,200 sub-treasuries and in a large number of the 300 district treasuries. In U. S. A. the sub-treasuries which had existed since 1846 were abolished in 1920, and this effectively did away with the embarrassments caused by the holding of idle funds in non-banking institutions.[1]

[1] Dewey: "Financial History of U.S.A.," p. 515.

The necessity for the movement of idle funds to disbursing centres has been considerably obviated in India by the system of 'currency chests,' whereby the metallic reserves of one centre can serve as the basis of a currency-issue at another centre, and *vice versa*. All these steps have meant a more effective utilization of Government balances. "The principle we adopted throughout," said Sir William Meyer in referring to the success of the first war loan in India, "was to leave the loan proceeds with the Presidency Banks, where they could be made available for trade purposes, until we actually needed them for disbursement, or the banks especially requested their withdrawal; and the Presidency Banks, on their side, were ready to give assistance to other banks which might find themselves in temporary difficulties owing to the sudden withdrawal of their deposits."[1] A good deal of support is lent to our contention, that higher public deposits in banks may be ultimately helpful to the success of Government loans. High Government balances with the banks in the slack season of the year, however, do not solve the chronic problem of tightness in the money market in India, where money is most

[1] Budget Speech, 1918.

needed for business purposes from November to March.

While the real explanation for seasonal stringency in the money market in India must largely be sought in the large concentration of business of the commercial community in the winter months of the year, the heavy withdrawal from the market of funds raised on Government account by means of direct loans, especially for disbursements outside India, must also be admitted to exercise an influence in the direction of tighter money. An apt illustration of this phenomenon is to be found in the fact that from the 31st March 1925, to 31st March 1928, the Government of India's direct rupee borrowing operations were concerned merely with the conversion of old maturing obligations, and did not involve any withdrawal of fresh money from the market at all,[1] with the result that, although admittedly the Bank-rate during these three years rose in the busy season, yet the highest rate did not go beyond 7 per cent, in spite of lower Government balances in those three years than at any time in the previous twelve; whereas, before and after that interval,

[1] Direct loan debt stood at 370 crores of rupees in 1925, and at 372 crores of rupees in 1928.

the rate has been up to 8 and 9 per cent. When, therefore, the Government of India demands heavier drafts on the money market in India than before, it becomes all the more incumbent on it to take proper steps to relieve the seasonal stringency in the busy trade season. "The action of the Government," wrote the Chamberlain Commission,[1] referring to the withdrawal of funds from India to London, "undoubtedly helps to create the annual stringency, and there is therefore at least a *prima facie* case for such counteraction as is possible to relieve it."

The steps to counteract this seasonal stringency have been of two kinds. In the first place, the Government has from time to time taken to itself wide powers to increase the limit of the fiduciary portion of the note-issue. In 1914, this part of the currency issue stood at 14 crores of rupees. By various enactments, the limit has now been extended to 100 crores of rupees. When the limit was raised from 85 crores to 100 crores early in 1925, the justification given was the relief to the money market. "As the busy season approached," wrote the Controller of Currency in his Report for 1924-25, referring to

[1] Para 143.

the inadequacy of fiduciary limit provisions, " it seemed probable that this limitation of the amount (85 crores of rupees) of the fiduciary note-issue might result in a shortage of currency and undue money stringency." It was on the strength of this argument that the Legislature granted larger powers for the issue of paper currency on the security of the I. O. U. of the Government of India. The second important step taken to achieve the same object has been the passing in 1923 of the legislation necessary to empower the Government to issue emergency paper currency in the busy season to the extent of 12 crores of rupees against trade bills of early maturity deposited with it by the Imperial Bank of India, an issue of 4 crores being permitted to the Bank when the Bank-rate rises to 6 per cent, the remaining 8 crores now becoming available if the rate goes up by another one per cent.

While the Government has helped the market by leaving larger balances at its disposal, and by its power to issue additional fiduciary currency or emergency paper currency, the banks have been greatly instrumental in assisting the Government to develop a short-term loan market by the Ways and Means advances and the evolution of the Treasury Bill system. The following

table shows the amount of Ways and Means advances from the Presidency Banks or the Imperial Bank of India in the period under consideration:—

WAYS AND MEANS ADVANCES FROM THE PRESIDENCY BANKS OR THE IMPERIAL BANK, 1917—29 [1]

Year	Amount	Institution
1917-18 ...	Rs. 4 crores	Bank of Bombay
1918-19 ...	" 9½ "	do.
	" 7 "	Bank of Bengal
1919-20 ..	" 11 "	Bank of Bombay
	" 7½ "	Bank of Bengal
1920-21 ...	" 3 "	Bank of Bombay
1921-22 ..	" 15 "	Imperial Bank
1923-24 ...	" 5 "	do.
1927-28 ...	" 5 "	do.
1928-29 ...	" 23½ "	do.

It must be definitely stated that Ways and Means advances have nothing to do with the

[1] Compiled from the Finance and Revenue Accounts of the Government of India.

permanent debt of the Government. "Such advances," wrote the Cunliffe Committee, "afford a legitimate method of tiding over a few weeks' shortage, but are entirely unsuitable for borrowing over a longer period." They are nothing more than a means of putting the Government in possession of funds in anticipation of revenue receipts. "This is a device," wrote the Chamberlain Commission[1] on the system of Ways and Means advances, "not practicable in India, where the resources of the money market are as yet too limited to enable the Government to rely on financing themselves through the lean months by borrowing." Yet the extent to which these advances have developed during and since the war shows how, in fact, new temporary resources have become available to the Government to tide over the lean months of the year. In England, the system of Ways and Means advances is sufficiently well established for some sort of equilibrium in the demands of the Exchequer upon the cash supplies of the nation to be maintained. The Government borrows before its revenues are collected and pays back when its revenues are

[1] Para 137.

received, so that there is in general no stringency in the money market.

Treasury Bills.—The banking community has rendered great assistance to the Government in making a success of the Treasury Bill system which was first introduced in India in the year 1917. The following table shows the amounts of Treasury Bills outstanding at the end of each year since the date of their introduction :

TREASURY BILLS OUTSTANDING, 1917—29 [1]

(In crores of rupees)

Year		Issued to public	Held in Paper Currency Reserve	Total
1917-18	...	43·57	...	43·57
1918-19	...	49·24	...	49·24
1919-20	...	52·98	...	52·98
1920-21	...	104·93	..	104·93
1921-22	...	53·96	57·89	111·85
1922-23	...	21·58	49·65	71·23
1923-24	...	2·12	49·65	51·77
1924-25	...	·004	49·65	49·654
1925-26	...	·0015	49·65	49·6515
1926-27	..	·0015	41·47	41·4715
1927-28	...	7·58 [2]	31·93	39·51
1928-29	...	3·99 [3]	39·15	43·14

[1] Compiled from the Finance and Revenue Accounts of the Government of India.

[2] Total issues to public were 30·37 crores of rupees in this year, but the rest of them were repaid during the course of the year.

[3] At one time the amount of Treasury Bills issued to public stood at 29·96 crores of rupees, but the rest of them were repaid.

These bills run for a period of 3, 6, 9 and 12 months, subject to renewal at the end of each period, thus forming a floating liability of the Government. In certain years they were issued in larger amounts than those shown at the end of the year. They are issued in amounts of 5,000 rupees and over, so that only banks and financial houses can participate in their purchase. Being issued at a discount, they are, indeed, so to speak, a kind of interest-bearing currency notes. Their early maturity, however, is a source of great embarrassment to the Government. While they are useful for raising funds temporarily, it is not wise to allow any considerable portion of the State's permanent liabilities to be held in this form. If, however, banks make it a practice to keep a part of their liquid assets in the form of Treasury Bills, such bills can serve as a useful supplement to Trade Bills as a basis for the issue of emergency currency in India in the busy season of the year.

Facilities by Banks to Subscribers to Government Loans.—Another important matter in which the banks have co-operated closely with the Government is in the extension of the public debt work from the head offices to all branch

offices of the Imperial Bank of India. Since January 1921, when the Imperial Bank of India came into being, over a hundred new branches have been opened. Any extension of banking, with the facilities it provides for the transaction of public loan business, is bound to have a wholesome influence on the popularity and success of the public issues. To-day, the management not only of rupee debt in India, but also of the London-enfaced rupee paper, is entrusted to the care of the Imperial Bank of India.

Finally, the banks have on certain occasions taken up 'firm' considerable portions of public loans. The underwriting of public loans, in the peculiar circumstances of the limited money market of India, is an onerous affair, and the co-operation of the banks is a valuable aid. An example of this type of assistance was the 1915 loan which was underwritten by the Presidency Banks at a discount of 1 per cent.[1] In addition to acting itself as subscriber to loans, the banking system—chiefly, in this respect, the Imperial Bank of India—has on certain occasions afforded facilities to subscribers to Government loans, by arranging for them bank accommodation for a

[1] Financial Statement for 1916.

longer interval than the period for which the Government loan has remained open.[1] Such facilities were given to the subscribers of the United Provinces Development Loan in 1921. In the case of the 1929 Government of India rupee loan, also, similar facilities were made available to subscribers in order to enable them to purchase more Government Paper than they could afford to buy at the moment.

First Serious Attempt at Tapping Indigenous Resources.—While closer co-operation between the Government and the banks has brought about easier conditions and aided to the success of Government loans, it must be frankly recognized that this success has been mainly due to the fact that larger incomes have been earned by the people in one way or another, and also to the economic stimulus of the numerous special attractions and facilities that have been offered in connection with the war and post-war public borrowing operations. When, on the shutting down of the London money market for external borrowing, the Government was

[1] The Bank of Mysore, also, recently gave facilities to subscribers to the Mysore State loans for advances to be repaid in easy instalments.

compelled to consider ahead the mobilization of internal resources, it gave up much of the conservatism which had formerly attended its loan policy, and made many new departures with a view to stimulating the interest of the indigenous investor. The most important attraction, of course, was the offer of a higher, and increasingly higher, rate of interest. We have already seen how, in the pre-war period, rupee loans were raised as a part of the 1900-01 $3\frac{1}{2}$ per cent non-terminable loan, and how, in the immediate post-war period, the open rate of interest gradually rose to 6 per cent and even more. This yield was further substantially increased for heavy investors by the issue of tax-free securities in the case of almost all the loans raised between 1918 and 1925. Besides these concessions, all the long-term loans in the war and post-war period were issued at a discount, and some of the short-term bonds carried the privilege of a redemption-premium. It cannot be said with certainty how far the conversion facilities, in 1916 and 1917, of 3 per cent and $3\frac{1}{2}$ per cent paper into new loans, at a slightly better than their prevailing market-price, brought in new money into the coffers of Government, but the bait was cast in an attempt to encourage the old

investors in Government securities to participate in the fresh capital issues. War always reacts unfavourably on the market value of gilt-edged, particularly governmental, securities. With a view to counteracting the evil of heavy depreciation in the value of the newly issued securities, and to maintaining their character of easy marketability, special Depreciation Funds were attached to the two 5 per cent 1917 and 1919 long-term loans, and also to subsequent issues of the latter. Partly to avoid the same danger, but particularly to enable banks and big financial houses, which cannot lock up their resources indefinitely in long-term loans, to participate more effectively as borrowers, bonds of early maturity extending over 3, 5, 7 and 10 years were issued. And in addition to Stock and Promissory Notes, Bearer Bonds, which are easy to transfer, began to be supplied.

One of the most important of the recent improvements is the extension of facilities for investment to the small investor. The starting of Post Office sections of the regular Government loans and of 'on-tap' facilities for the issue of Post Office Cash Certificates; the practice of keeping loans open for very long periods of time extending sometimes to several months; the

reduction of the minimum amount of Government Paper which could be subscribed to Rs. 25, and the raising of the maximum amount of individual tax-free Government Paper allowed to be kept in the custody of the Accountant-General to 22,000 rupees; the general improvement in the Public Debt Office facilities, at the headquarters of the Imperial Bank of India, and in the transaction of loan business at all Government treasuries and sub-treasuries—all these steps, though they may not have added a monetary yield of imposing figures, have none the less tended to popularize investment in Government securities. During the war, of course, a number of special factors contributed to the success of the borrowing efforts. The chief of these were the intensive official propaganda in favour of War Loans, the motive of patriotism, restrictions on the issue of other forms of capital, recognition of the fact that money had to be raised from internal resources, and the high profits made by cotton, jute and other industries.

Borrowing Methods of Other Countries.— It may be instructive at this stage to discuss the borrowing methods employed by certain other countries, particularly those adopted during the

war by the various belligerent nations, whereby most of them made new financial history. One of the most important of such methods was the facility offered, at an early or advanced stage of the war, by the Central Banks in most of the countries concerned, of re-discounting newly-issued loan paper for different intervals of time, possibly at the same rate, but usually at a rate of interest either actually below that carried by the loan paper, or at a substantially lower rate than the market discount rate, sometimes directly to the customers, sometimes by arrangement through other banking institutions. The Bank of England, for instance, announced during the British War Loan Campaign of 1914, that it would lend on the new Bonds at the issue-price "at a rate not exceeding 1 per cent below the current Bank-rate" (which then was 5 per cent), and that repayment would "not be demanded by the bank before March 1st, 1918, provided interest is annually paid."[1] In the United States of America, the Federal Reserve Banks announced through public advertisements to subscribers, that "we will lend you money secured by the Fourth Liberty Loan at $4\frac{1}{4}$ per cent (the same

[1] *Vide "Financial Chronicle,"* January 23rd, 1915.

interest rate as on the loan itself) for ninety days, with renewals at the same rate covering the entire period of one year."[1] The Federal Reserve Banks thus made it possible for bond-holders or intending holders to borrow on easy terms. Further, a preferential rate of discount was offered on notes of member banks secured by Government obligations. "As the re-discount rate was no greater than the interest on the Government obligation, it was possible for a purchaser of a bond to secure funds by pledging it as collateral with his bank, which, in turn, re-discounted the note with the Federal Reserve Bank."[2] The extent to which subscribers used this privilege was shown by the increase in the amount of War Bonds held as collateral for loans, at all the national banks, from \$340·7 million, in March 1918, to \$1,213 million in September 1919.[3] In France, too, similar re-discount facilities were granted by the Bank of France to bond-holders. In Australia, when the 6 per cent Commonwealth of Australia loan of £25 million was issued (at par) in 1920, arrangements were made with the banks "to

[1] Annual Report of the Federal Reserve Board for 1919, p. 68.
[2] Dewey : "Financial History of U.S.A.," p. 504.
[3] Noyes : "The War Period of American Finance," p. 191.

advance up to 90 per cent of the amount applied for by customers who have a good prospect of paying the money within 18 months, these special advances being at 5 per cent interest."[1] In the preceding year, when a loan was raised for a similar amount by Australia at an effective yield-rate of interest of $5\frac{1}{4}$ per cent, arrangements had been made with the banks to make advances to customers at 4 per cent per annum, where reasonable prospect of repaying the money within 18 months existed, the banks advancing up to 90 per cent of the amount.

In all these cases, the help of bank credit thus invoked resulted in substantially increasing the subscriptions to the loans raised in the War and Armistice periods. A large number of individual subscribers by this means not only drew on their accumulated savings, but also borrowed in anticipation of prospective income and subscribed the proceeds. The expedient, dubious in certain respects, was, of course, wholly justifiable, so long as it merely brought about the assignment in advance of an assured income, accruing in the future. Another important influence that this step exercised—particularly

1 *Vide "Economist"* (Melbourne Correspondent), August 9th, 1920.

in the United States of America, where the policy of the Reserve Banks was closely co-ordinated with Treasury requirements and policies—was a tendency to keep down the general money rate for all other requirements.

American Methods of Borrowing.—American methods of borrowing[1] have so many interesting features, that we propose to explain them in somewhat greater detail.

Total borrowings amounting to about \$25,000 million were made by that country for internal needs and advances to the Allies, within a short period of 28 months (between April 1917 and August 1919), at extraordinarily low rates of interest, ranging between $3\frac{1}{2}$ per cent and $4\frac{1}{4}$ per cent, which were actually less than the prevailing money-market rate. Loans were not issued at a discount, though most of them carried the privilege of exemption from income and all other Federal, State and city taxes in varying degrees. In America, greater and more spectacular emphasis was laid on

[1] For most of the facts on which this section of the Chapter is based, see Noyes : "War Period of American Finance" ; Dewey : "Financial History of U.S.A." ; Annual Reports of the U. S. A. Treasury for 1917, 1918 and 1919.

the war loan 'drive' than in Europe. The loans were known as "Liberty Loans"; each of the 12 Federal Reserve Banks created Liberty Loan Committees and Sub-Committees, with the co-operation of bankers, businessmen, bond-houses, newspapers, press associations, fraternal organizations, and Boy Scouts and Girl Guides. The Secretary of the Treasury visited twenty or more places during the subscription period of a loan. In the Fourth War Loan Campaign (1918), 24 railway trains were driven over the country with exhibits of captured war material, ordnance, and ammunition, accompanied by veteran soldiers and sailors. The designing, distributing and displaying of "Liberty Loan posters" became, in its way, a new art and industry. All-day "Liberty Loan rallies" were arranged. A familiar incident was the call for subscription from theatre-audiences between the acts, after an impassioned appeal by a well-known actor or actress, a wounded soldier, or a Red Cross nurse. In the closing week of the Fourth Liberty Loan 'drive', in October 1918, \$4·8 million was raised from a single audience at Carnegie Hall. At an open air meeting in New York on the last day of the 'drive,' \$3 million was subscribed after speeches by the Governor

and the Mayor. Appeals were made by members of various professions, including the best-known movie-picture stars. The Treasury reported that in the Victory Loan Campaign of 1919, speeches were made by 5,000 well-known men and women, and Liberty Loan sermons delivered by 100,000 clergymen. An organization with a Speakers' Bureau and a Publicity Bureau to carry on propaganda through posters, buttons, flags and advertising copies was set up. Two million men devoted themselves to the work of distributing bonds. In each of the three last Loan Campaigns, President Wilson proclaimed a special "Liberty Day" at the climax of the 'drive,' and it was generally observed as a holiday. All kinds of securities, convenient to individuals or corporate bodies, for short intervals or long, for tapping the present income as well as resources yet unearned, for the small investor and the big bond-holder, were issued, and thus fabulous amounts were raised in a country where the greater number of the population had never invested in a Government bond before. Dividends were paid in the shape of Liberty Bonds.

In 1918, the banks were asked to reserve 1 per cent of their resources to be employed in short-term Government loans. The Government gave

Bonds to the Reserve Banks; the latter handed them over to the member banks; and these last, in their turn, passed them on to customers. Quotas of States and Federal Reserve districts were fixed, and rivalry was excited. The First War Loan (1917) wanted $2,000 million but elicited applications for $3,000 million by 4 million individual subscribers. The second Loan asked for $3,000 million, and $4,617·5 million was applied for by 8·4 million subscribers. In the third Loan (1918), the issue was for $3,000 million but the applications amounted to $4,158·5 million, the number of subscribers being 10·37 million. For the fourth loan, the offer was made for $6,000 million, but the amount taken came to $6,992·9 million, individual subscribers numbering 22·77 million. Finally, the Victory Loan which offered $4,500 million was over-subscribed by $749 million.

"Diversion of private capital on such a scale from its ordinary uses might cause extreme scarcity of money, withdrawal of capital from other investments for subscription to the war loans might completely demoralize the stock exchanges. Financial tradition taught that such immensely heavy borrowings might result in very high money rates, and a great decline in

outstanding stocks and bonds. Yet neither result accompanied the war borrowings of 1917 and 1918."[1] The explanation for this paradox was furnished by the low interest borne by the Liberty Bonds, and the maintenance of their price in the open market by the policy adopted by the Federal Reserve Banks. The official re-discount rate of the Reserve Banks was kept at 4½ per cent, and a still lower rate was granted on re-discounts secured by war loan collateral.

The methods employed with a view to making the capital issues successful in some countries, included the underwriting 'firm' by banks of large portions of the loans issued; the practice of keeping loans open for very long intervals; the payment of instalments by the "pay-as-you-please" method, spread over several months; the flotation of loans at a very high discount[2]; the issue of loans at a fixed rate of interest liable to rise to a higher rate under certain conditions[3]; the issue of loans with more than

[1] Noyes: "War Period of American Finance," pp. 201-02.

[2] According to Prof. Gide (*Annual of the American Academy of Political Science*, May 1921), the loans in France were issued at such a heavy discount that the average issue price was about 76·6 per cent up to war, and about 85·4 per cent up to the end of 1920.

[3] See Report of the Committee on National Debt and Taxation, p. 41.

two optional dates of redemption (e.g., the Australian 1920 loan, made redeemable in 1931, 1936 or 1941), and loans with other kinds of concessions such as the acceptance of loan paper at Treasuries in payment of certain taxes (e.g., in England and France, where government paper of certain loans was acceptable in payment of Excess Profits and Inheritance taxes); or the option of converting a given loan into any loans raised in future. A far-reaching attempt to attract the investors was the Drummond-Fraser plan adopted in Great Britain of keeping the National Bonds open and continuously 'on tap' in an endeavour to get £25 a day from September 1917 onwards. More striking still was the law passed in New Zealand for compulsory contribution to Government loans, and the introduction of legislation on similar lines in the Australian Commonwealth, whereby all income-tax-payers in the Dominion were required to contribute to Government loans six times the average amount of the income-tax paid for three years, on pain of a fine of double the amount of the tax. A crude but interesting way of developing the local money market adopted by China was to contract short-term loans at a progressively higher and higher rate of interest as time passed, on

promise of repayment by annual drawings starting with the year following the issue of the loans.

STEPS FOR INDIA

Necessity of a Central Reserve Bank for India.—We have discussed rather at length the steps that some other countries have taken for the development of indigenous capital resources. We have also shown how, under the influence of a number of factors, the position in India has considerably changed for the better as regards both the mobility of capital and its investment in government securities.

We come now to the most important part of this chapter, namely, a discussion of the steps that can be usefully taken to mobilize further the present immobilized wealth of India by an effective use of public credit. The most progressive step in this direction that should be taken without avoidable loss of time is the establishment of a Central Bank, with a unified reserve system, and control over currency and credit, enjoying liberal powers of re-discounting both commercial and, in certain cases, governmental paper endorsed by other banks. An institution of this type mobilizes national credit and financial resources. "The other special function," says Fisk, referring to

the functions of the Bank of England,[1] "served by the Bank is that of mobilizing the financial resources of the people for great financial and commercial emergencies, and specially for meeting the needs of the Government in time of war. This is accomplished because of the fact that the ultimate banking reserve of the nation carried with the Bank can be made the basis, on occasion, for a great expansion of credit. . . . The reserve of the joint stock and private banks deposited with the Bank, has come to be considered a basis for an extension of credits to their borrowing customers. As a result of long experience, it is found that a given reserve is sufficient to warrant the granting of credits for several times its amount. The principle is well known to bankers, and constantly observed in their transactions." We have already shown in detail elsewhere in this chapter how, in some other countries, the Central Banks have powerfully assisted their national governments in the latter's temporary and permanent borrowing programmes. A central organization, ready to help other financial institutions in times of acute monetary stringency

[1] Fisk: "English Public Finance," p. 171.

by granting credit by means of an elastic currency, will tend to make monetary conditions easier and to assist very largely the Government's borrowing operations. "The State Bank," said Sir M. B. Dadabhoy in the Council of State, in the course of a debate[1] on the provision for debt amortization, "when constituted, should also be authorized to issue seasonal currency against inland commercial paper. When this is done, there will be a flow of great prosperity in the country, and the Government of India will have the good fortune to obtain large sums of money whenever they desire at a cheaper and less burdensome rate."

Need for a Board of National Investment in India.—The next necessary step is the establishment of an Indian Board of National Investment, somewhat on the lines of the recommendations contained in the Report of the British Liberal Industrial Enquiry,[2] to take over the affairs connected with the Indian public debt. Most countries having a public debt have also a National Debt Commission to supervise the administration of the

[1] In September, 1924.

[2] "Britain's Industrial Future," pp. 111—115.

debt transactions. For example, Great Britain, Japan, South Africa and Australia, all have their National Debt Commissions. Great Britain has, also, a body called the Public Works Loans Board, which undertakes to finance the smaller local bodies that cannot raise independent loans on the strength of their own credit. Australia has recently set up an additional organization called the "Loan Council" which controls all Federal and State borrowings, both external and internal. It is very surprising that India, with a public debt of all categories—central and provincial, funded and unfunded, external and internal, productive and unproductive, short-term and long-term, temporary and irredeemable—amounting to over 1,200 crores of rupees (about £900 million) should not have an analogous body to organize its operations. There are many funds, deposits, balances and reserves in India—such as the proceeds of the Postal Cash Certificates and Savings Banks, provident funds, judicial and other deposits, the Famine Insurance Fund, the Railway Depreciation and Reserve Funds, the Sinking Fund contributions of the central and provincial governments, and similar other loanable moneys—which now go to assist the general Ways and Means position

of the Government of India. It is necessary to separate such interest-bearing funds, intended for investment, from the general Treasury balances, pool them, and entrust the work of their investment and management to the care of an independent body composed of representatives drawn from all the interests concerned. In addition to the investment of the above and other such funds, the proposed organization should arrange for such matters as the issue of direct loans, the conversion and redemption of early maturities, the distribution of loanable funds between the central and provincial governments, the purchase and sale of securities, and the creation of facilities for the sale of sterling paper in India and submit an annual report to the Treasury giving an account of its activities. The usual practice in Great Britain is to do all borrowing through the Treasury and the Bank of England, and to arrange part repayment through the National Debt Commission. But there is a great deal to be said for the co-ordination of borrowing, reborrowing, and repayment functions, and their transfer to a separate independent body. We have already referred to the establishment of the *Caisse D'Amortissement* in France, which has taken over the entire charge

of the interest services, and the reimbursement and renewal of the whole short-term debt of France.

An institution like the one we have suggested would help in gradually standardizing the rates at, and conditions under, which loans are assigned to different borrowing institutions such as the railways, the provinces, and other public bodies. According to the present practice, different considerations govern the determination of the rates of interest charged on advances made by the Government of India to different classes of borrowers. "The rate of interest charged on advances to Government servants, has been fixed for the present at 5 per cent, while the rate charged on loans and advances to Indian States, public bodies and persons, etc., is normally 6 per cent, though it is occasionally varied for special reasons. The rate of interest charged by the Government of India to the Provincial Loans Fund is determined with reference to the cost of new borrowings to the Government of India from time to time."[1] It is stated, however, in the same publication, that "the rate of interest charged on advances to the Provincial Loans Fund during

[1] Finance and Revenue Accounts of the Government of India for 1927-28, p. 645.

1927-28 was $4\frac{3}{4}$ per cent."[1] We have pointed out elsewhere,[2] that the rate of interest paid by the Commercial Departments came to 5·38 per cent in the year 1927-28. There is therefore a *prima facie* case for some sort of standardization of the rates of interest to be charged from the borrowing *clientele* of the Central Government.

With command over large funds received from the lending departments, and with other incoming resources, the new institution would, on certain occasions, be in a position to dictate favourable borrowing terms to the money market on its own capital issues. All the materials for the framework of a body similar to the National Investment Board, which has been recommended for Great Britain in the report of the Liberal Industrial Enquiry, already exist in India. There is a considerable amount of co-ordinated borrowing by the Central Government for all purposes, there is the nucleus of the fund for administration by such a body in the form of the Provincial Loans Fund set up for the purpose of granting loans to the provinces, which is financed from funds raised by the Central Government, there are the investing departments, and there

[1] Ibid., p. 293.
[2] P. 275.

are the departments that need borrowed funds. What we urge is merely a transfer of all these banking and investment functions from the hands of the Finance Department of the Government of India to the care of a separate organization working under the close control of the Treasury. "I look forward to the day," said Sir Basil Blackett in foreshadowing future developments in the working of the Provincial Loans Fund,[1] "when the Fund may be administered by an Indian body corresponding to the National Debt Commissioners, or the Public Works Loan Commissioners in England, and the money required for advances from the Fund raised in the open market by the controlling body, on the security of the assets of the Fund. It is too early yet to say when such a development, though it may already be foreseen, will materialize. I am confident, however, that considerable benefits will accrue to the finances of India when the day comes on which the advances made by the Central Government to the Provincial Governments will be excluded from the Public Debt of the Government of India in the same way as advances made on the guarantee of the British Treasury to public bodies in the United Kingdom are

[1] Budget Speech, 1925, para 36.

excluded from the British Public Debt. Not only these advances to the Provincial Governments, but also the Railway Debt of the Government of India may ultimately be separated from the ordinary debt, and raised, subject perhaps to a Government of India guarantee, not on the general credit of the revenues of India, but on the security of the assets of the Provincial Loans Fund and of the railway undertakings of the State, respectively. The true facts regarding the public debt of India would be less obscure than they are, and the facilities for raising new capital would be widened."

Almost similar views have been expressed by the Indian Statutory Commission. Referring to the standardization of the regulations for provincial loans, and the co-ordination of their borrowings, the Simon Commission propose that there should be set up in India a Provincial Loan Council, consisting of the Finance Member of the Government of India and the Finance Ministers of the provinces.[1]

Financing of Local Bodies.—We have already shown,[2] how the direct loans of the

[1] Simon Commission Report, Vol. II, p. 267.

[2] Chapter III on the Provincial Debts.

provinces have been raised on more expensive terms than those of the Central Government. Important local bodies, that enjoy independent powers of borrowing, have also sometimes encountered difficulties in financing themselves. In the Report of the Municipal Administration of Calcutta for 1925-26, is to be found the following interesting passage:

"The 6½ per cent debenture loan of 1924-25, dated 1st November 1924, for 5,54,500 rupees having fallen short by 10,000 rupees of the amount to be raised under Section 108 (2) (ii) for repayment of the 4 per cent loan of 1899-1900 which fell due on 1st November 1924, a supplementary loan of 11,000 rupees was raised during the year under report."

Calcutta, which was largely responsible for the contribution of 12 crores of rupees from Bengal to the First War Loan (1917); Calcutta, about which the 1921 Railway Committee had said that it alone could easily raise a sum of 4 crores of rupees annually for railway construction purposes; Calcutta, the most important, or the next most important, nerve-centre of the money market in India, failed to raise for the benefit of its own citizens, in order to repay an old debt, in one loan—and that a debenture loan at

$6\frac{1}{2}$ per cent—the paltry sum of $5\frac{1}{2}$ lakhs of rupees, and had to raise a supplementary loan of 11,000 rupees in order to make up the amount ! A more serious indictment of the existing system of financing local bodies it would be difficult to find.

Yet these big public bodies sometimes have quite large Sinking Funds at their disposal for investment.[1] The debt of the Bombay Corporation in 1926-27 stood at 18·4 crores of rupees, and its Sinking Fund, in hand or invested, at 2·95 crores. The Port of Rangoon, which had a rupee debt of over 4 crores on the 31st March 1928, besides a sterling debt of half a million pounds, held 161·8 lakhs of rupees in the Sinking Fund, which was invested in 23 different loans of the Government of India, the Rangoon Port Trust, the Rangoon Corporation, and the Calcutta Port Trust. The Bombay Corporation Report for 1926-27 states that a proposal, dated the 23rd July 1926, to consolidate all its outstanding development loans into one loan at 5 per cent and of repaying the loan in 30 equated instalments of 11·62 lakhs of rupees a year, was

[1] See p. 11.

disapproved by the Government of India. A perusal of the annual reports of some of these bodies shows that they have sometimes to spend considerable amounts of money in discounts, brokerage, and other charges in connection with their direct external and internal loans. Some of them even carry short sterling obligations. A body like the one the establishment of which we are suggesting, ready to finance all important local bodies and agreeing to receive payment in the form of annuities including interest and sinking-fund payments, spread over a period of years appropriate to the character of the loan expenditure, would avoid the considerable waste due to the present overlapping and a great deal of the inconvenience that is frequently faced by the borrowing institutions.

It would not only perform the functions of propaganda and publicity as to the true position of the Indian Public Debt, but would serve to maintain confidence in the minds of external and internal investors by a judicious discharge of the work assigned to it. Such an institution could, also, effect a desirable separation between the commercial and the unsecured debt, a step that would lead to the avoidance of political controversies as regards any section of the public debt.

Greater Reliance on Other than Directly-Borrowed Funds.—We are concerned to urge in this book a much more extended reliance on the part of the Government of India, on sources other than the direct borrowings in the open money market. At the same time, however, it is highly desirable that entries into the open market should be more systematically planned. There should be, say, quinquennial or decennial periods of heavy capital programmes to be financed out of direct borrowings, and then a lull to give the money market a breathing space. Australia is a special case, but this country has recently curtailed its loan programme by 50 per cent. All writers on public finance, however, agree that popular loans should be few. The Government of India already annually receives a few crores of rupees under certain heads for investment. It should become part of a definite policy to offer such attractions as would increase the yield under these heads; and then to attempt to restrict the execution of more urgent programmes to the sum obtained through these investing departments. A quotation from the Indian Budget Speech of 1929 will serve to make this general argument clearer: "In the five years from the 1st April 1923 to the 31st March 1928," said Sir George Schuster on this

occasion, "Government undertook capital expenditure amounting to about 120 crores of rupees and about £49½ million. As against this sum, they raised by way of loans from the public, a net amount (by which expression I mean the net proceeds of the new loans, less the amount of old loans and Treasury Bills paid off) of about 12 crores of rupees, and about £13 million. That is to say, during these five years, sums of no less than 108 crores of rupees and £36½ million were provided from sources other than an increase in what is generally known as the public debt."

The money was provided from the following sources :—

		Rs. (Crores)
(i)	Post Office Cash Certificates and Postal Savings Bank Deposits ...	37
(ii)	Other Savings Bank Deposits ...	19½
(iii)	Revenue Surpluses including Revenue Reserve Fund	12
(iv)	Provision for Reduction or Avoidance of Debt	22½
(v)	Other Appropriations from Revenue	3
(vi)	Reduction in Opening Cash Balances in India	16¾
(vii)	Depreciation and Reserve Funds ...	25½
(viii)	Provident Fund Balances from Railway Companies	9
(ix)	Gain by Exchange	7¼

We cannot look forward for the financing of the Indian railways and provincial administrations to such foreseen or unforeseen windfalls as are included in items (iii), (v) or (ix) above, but we do certainly recommend encouragement of the growth of heads (i), (ii) and (viii) and, in addition, would always take into calculation the amounts available under items (iv), (vi) and (vii). Postal Cash Certificates we have already discussed at length. Steps should be taken similarly to ensure a larger flow of provident funds from semi-official institutions.

In the fourteen years from 1914 to 1928 the Government's 'other obligations' yielded 80 crores of rupees, or the respectable sum of about 6 crores of rupees annually. In some years, Cash Certificates alone have yielded more than this sum. The total *average* amount received under (i), (ii), (iv) and (viii) works out at 23 crores of rupees annually for the quinquennium 1923—28. It should not be difficult to bring this figure up to 40 crores of rupees, the normal annual requirement of the Central and Provincial Governments. For producing additional money, therefore, during the period in which, as we propose, relief should be given to the money market, a permanent arrangement might be made for 5 and 10-year

bonds to be available on sale from the post offices or branches of the Imperial Bank of India in certain weeks during the slack season, say, in June, July or August, of the year. Power could be reserved to the Government to restrict the sale of such bonds in Presidency or other commercial towns if there were monetary stringency and the Bank-rate during those weeks happened to be high. Dull periods could be utilized for conversion operations on easy terms, as was done in the interval between 1925 and 1928 to which we have previously referred.[1]

Limitations and Potentialities of the Indian Money Market.—The present limitations of the Indian money market can be very well studied in the light of the experience gained in the war and post-war periods. It must be clearly recognized that, as is bound to happen in a newly-developing country, the Indian market has shown a great capacity for yielding large amounts of money on short-term loan conditions. To expect the same amounts to be obtained for long-term investments in Government loans, however, is

[1] See p. 311.

to assume more than can be justified from the financial history of the last fifteen years. But while appreciating fully the significance of this fact, more extensive facilities should be afforded to distribute short-term bonds widely in areas other than the present monetary centres. The surplus purchasing power of the community, as represented by the excess of exports over imports, is widely distributed among the large population spread over the wide area in which banking has not developed to any considerable extent, where the co-operative movement has made but little headway, where other mobilizing institutions such as Building Societies, Trustee Savings Banks, Investment Trusts, Friendly and Provident Societies, found in Britain, have not been developed, and where finally the importance of insurance has not attracted popular attention.

The crux of the problem in these circumstances is to take effective steps to interest the large class of small and scattered investors. As the present writer has pointed out elsewhere,[1] the possibilities for the development of capital resources in India are very great. The position is (i) that India's potential capital is large enough

[1] Dubey: "Indian Economics," p. 206.

to meet her growing industrial requirements, but (ii) it is timid and conservative, and, finally, (iii) it requires to be drawn out. "That internal capital is available," wrote the External Capital Committee (1925), "is shown by the increase in Government rupee loans from 145 to 358 crores, and in the paid-up capital of the joint stock companies from 80 to 250 crores between 1913-14 and 1923-24, an increase of 387 crores. The fact, however, that the net imports of gold and silver since 1913 amount to 482 crores, is evidence that large resources are still being hoarded which might be invested." The problem, therefore, is to provide institutions in India that will overcome the timid and conservative character of the possessor of capital and draw it out from his hoards. Banking can make only slow progress. In the vast country that India is, there are only about 500 bank offices, and the effectiveness of these is to be discounted by reason of the considerable overlapping which exists. "That the banking facilities in the country are inadequate for our population and resources, is shown by the mere fact that 20 per cent of our towns, having a population of 50,000 persons or over, and 75 per cent of our towns, having a population of 10,000 persons or

over, have no modern bank at all."[1] In Great Britain and Ireland there are 13,100 bank branches. Ireland alone has about 900 bank offices, and Scotland about 1,300.[2] In India, it will thus appear, we have only touched a fringe of the banking problem. It is not possible to forecast the recommendations of the Banking Commission now sitting in India, and the type of institution they will suggest to meet the requirements of Indian rural areas, but the belief is generally held that there is a mutual feeling of distrust between the man-in-the-street and the modern banker. The former has no security to offer for a bank accommodation, while he cannot bring himself to trust a banker to take care of his small savings. In many instances, moreover, a regular branch, or even a branch working only on particular days, is not an economic proposition. Public credit, therefore, should be extensively used through the medium of the post offices which number about 20,000, in order to attract the small deposits of people of very scanty means. Concentration of attention on the small investor, specially outside the Presidency-towns, is the more necessary since the locking up of

[1] Ibid., p. 208.

[2] *Vide* Bankers' Almanac.

funds is not practised by the commercial community, whose floating balances always remain at the disposal of the money market in one form or another. Future attacks, therefore, should be specially directed towards those quarters that lock up the purchasing power in an uneconomic manner. If government paper can be made increasingly popular with the masses, it will provide them with instruments of credit for bank accommodation, encourage the growth of the habit of investment, reduce the import of precious metals for hoarding purposes, bring down the rate of interest in the rural areas, provide a healthy stimulus to the development of banking, ultimately increasing the purchasing power of the masses (and thereby their saving and taxable capacity), and, finally—no small point—will interest them more effectively in the stability of the government.

The Government's present loan organization is very imperfect. "We think," remarked the Majority Report of the Railway Committee of 1921,[1] "that the agency for the issue of Government loans requires to be organized much more thoroughly and on a much wider basis, and that the services of all banks, both European and

[1] Para 246, p. 73.

Indian, should be enlisted." The Minority Report[1] went one step further. They considered that the assistance of all banks should be enlisted when the Government came into the market for railway loans, and that even independent offers from banks or groups of banks on special conditions somewhat outside the ordinary Government terms, should not be lightly set aside. The general opinion of the Committee was that the Indian Government had not in the past exhausted all advantageous methods of raising money.

A great deal could be accomplished by the enlistment, in advance, of the support, not only of all the banks, but of other great financial institutions, and even of private capitalists, and in this way the participation of the whole public which has money to invest could be secured. It awaits only a systematic organization in the hands of experts, and other countries' experience ought to be taken advantage of. When, for instance, the Japanese Government carried out its conversion operations in March 1910, the representatives of fifteen banks in Tokyo and Osaka were summoned and asked to organize an underwriting syndicate to manage the general

[1] Para 306.

subscriptions, and an agreement was reached to take the unsubscribed portion of the loan if the subscribed amount fell short of the anticipations. Money was received through the post offices. Two other syndicates, including a larger number of banks, were formed for a similar purpose in the same year.[1] In America in October 1915 a syndicate of no less than 288 financial institutions underwrote an Anglo-French 5-year loan of $500 million.

Some of the Indian territorial princes are counted among the richest men in the world; many others, in accordance with their time-worn traditions, have large hoards in the coffers of their treasuries.[2] Their aid should be invoked, their co-operation invited, and any legal or constitutional obstacles in the way of their investing money in Government loans should be removed. After all, it is important to remember, there is a considerable amount of money-lending as well as exchange of landed property for money done in the country. A Burma witness said before the Decentralisation Commission that the capital issues of the Rangoon

[1] Kobayashi: "The War and Armament Loans of Japan," pp. 122-123.

[2] Shirras: "Public Finance," p. 467.

Port Trust used to be subscribed to by the Court of Wards of Madras. Personal invitations to great Indian landowners or capitalists would go a long way towards popularizing investment in Government securities, if only it is brought home to their minds that the object of raising money is to construct useful public works, and to release the Indian railways and irrigation works from their present mortgagees. The work of enlisting the support of the masses, on the other hand, will have to be done on a retail scale, and mainly through Indian agencies. The first step is the most difficult. The habit of investment grows only by practice. The experiment of a raging and tearing popular campaign to raise large amounts of money by loan in peace time has never been tried in India. Yet, while the understanding and goodwill of the enlightened and educated classes is essential, if efforts were also systematically made to enlist the active sympathy of the territorial and merchant princes and to secure the backing of the aristocracy and the confidence of the masses, any official efforts to socialize the Indian public debt would be bound to prove a success.

Effects of Heavier Internal Borrowings.—It now remains to discuss the effects

of more intensive rupee borrowings on the monetary position in India. Supposing that by short-term loans and the offer of more attractive rates, larger funds were raised by means of rupee loans, such a course would be bound to have repercussions on the supply of capital for other purposes. "I must respectfully point out," said Sir Manekjee Dadabhoy in the Council of State,[1] "that it was a great blunder committed by Government when they floated the sterling loan last year in England at 7 per cent, and when they permitted the Bombay Government to float the Development Loan at $6\frac{1}{2}$ per cent. What was the result? It temporarily ruined Bombay, because merchants and other people withdrew all their money from the joint stock companies and banks where it was deposited, and invested and employed it in the purchase of the $6\frac{1}{2}$ per cent Development Loan, with the result that there was no money left at a critical time for the purpose of carrying on the trade of Bombay."

Criticism of heavy rupee borrowings at high rates have been made from other quarters also. No one will dispute the temporary influence of heavy rupee loans on the investment market in

[1] On September 9th, 1924.

general, but does the present average rate of annual rupee borrowings really represent, in the long run, a heavy net withdrawal of fresh funds from the open market? It must be remembered, in this connection, that the Government itself is a large disburser of funds in the form of interest payments, funds which should normally be available for further investment. It is very interesting to note how much *new* money the Government has taken from the money market from 1914 to 1928 in view of the fact that considerable sums have been paid out by the Government as interest charges in India. The following table shows the proceeds under different heads:—

	Rs. (Crores)
(i) Excess of postal savings bank deposits over 1914 ...	8
(ii) Cash Certificates since 1917 ..	31
(iii) Excess of Provident and other allied funds over 1914 ...	46
(iv) Paper Currency Reserve Investment	31
Total ...	116

The above sources represent a total of 116 crores of rupees, while during the same period

the total internal debt has risen by 353 crores of rupees. Other sources, therefore, have supplied the remaining amount of 237 crores of rupees. During this period, the Government has paid out 210 crores of rupees as interest on the rupee debt. So that the fresh money taken by direct demands on what is called the Indian money market, amounts to only 27 crores of rupees in all. And if account is also taken of the not inconsiderable amounts of money allowed as discount on loans and premium on bonds during this period, the amount will dwindle to an even smaller figure of a few crores of rupees. The criticism of the policy of the Government from certain quarters, to the effect that it has absorbed the savings of the money market which would have been more profitably employed in the development of industry and commerce, is therefore hardly justified in the circumstances. The net result of the total drawings of the Government of India and the various Provincial Governments illustrates forcibly the truth of the argument that once the whole of the present external debt was converted into internal debt, the amount of interest paid by the Government to its creditors would create a fund which would be enough for the annual requirements of the Government. We have

estimated the annual requirements of the Government at 40 crores of rupees; that, in very round figures, is the total amount of interest paid by the Government. If we were to take into consideration the huge war-time profits and the large imports of precious metals made during this period, we should find that the Government has taken only a part of the total savings of the community.

But the annually-recurring entry of the Government into the market, for money needed for development of a particular kind controlled by the State, does, after all, affect to some degree the availability of funds for other enterprises. What can the Government do to encourage the promotion of legitimate, healthy and beneficial private enterprise? Company promotion, or the underwriting of promising capital issues, is no direct function of the State. Instances of State guarantees, or the State Loan Organizations assisting in underwriting industrial capital issues of national importance, however, are found in other countries. Instances have also been quoted elsewhere[1] showing that the provincial field of loans and advances is in some

[1] See Madras Administration Report (quoted pp. 169-170).

cases sufficiently wide and comprehensive. The increase in the assets of the Provincial Loan and Advance Account in the different provinces from 9 crores of rupees in 1921 to 37 crores of rupees in 1928, is a marked improvement. The time is ripe for the Government to go a step further, and, through a National Investment Board, assist the financial reorganization or reconstruction of industry; this it could do by providing facilities for the grant of long-term loans on easy terms of repayment out of the funds that are raised for general purposes, to approved types of industries under specified conditions. It is the more necessary since there are no industrial banks in India. Moreover, the State itself engages in industrial activity, and it is only fair that private enterprise should not be handicapped for want of the long-term finance which the former obtains. In this way, any shortage of money for long-term industrial investment resulting from heavy Governmental borrowings would be more than neutralized.

Palliatives for Tiding Over Seasonal Stringency.—Another important problem to be solved, however, is that of relieving the money market at the time of seasonal stringency when the Bank-rate

rises. It was recognized by the Chamberlain Commission that the average Bank-rate in India is not high.[1] Even if it were, it must be admitted that a high Bank-rate is not necessarily always bad. A rise in Bank-rate generally indicates brisker trade or business activity: a high rate attracts capital from abroad and checks the efflux of capital to foreign countries. The rate for bank-money, moreover, is not a very appreciable item in the cost of industrial production, and in India, when it is high, it is generally high only for a short period—a few months or so. From the point of view of private capital issues, it may almost be regarded as a blessing that there is a slack season with low Bank-rate in India, which should be fully used for the raising of capital for new industrial and commercial enterprises. Some provision is necessary, however, to give temporary relief to the money market in the busy season. Liberal facilities for re-discounting not only commercial paper, but also public loan paper of early maturity, provided by the establishment of a Central Reserve Bank, would go a long way towards easing the situation in this direction.

[1] Report para 142.

In some other countries, the object is achieved by obtaining short-term funds in foreign monetary centres. In a recent article[1] Prof. Gregory has discussed the undoubted "existence of a large volume of floating funds moving easily from one area to another under the impulsion of higher interest rates, or feelings of insecurity." He has estimated the amount of this "short-term fund" of international character, largely the product of the post war financial conditions, at £400 million. There is no reason why India should not take advantage of the existence of this fund by maintaining a policy of conservation of its own capital resources and checking the export of capital. If the Government draws heavily on the market in July or August when money is plentiful, it should actively assist the situation in winter and spring when funds run short. India Bills of a few months' maturity are a very familiar form of sterling borrowing on behalf of India in London. They are sometimes cheaper than long-term loans, as we have shown in the chapter on Sterling Debt. The community will stand to gain, therefore, if public credit is allowed to be used in that form in the interests of

[1] *Financial News*: World Banking Supplement, 1930.

general trade, as it is now used for Government requirements.

This second suggestion involves an important departure from the constitutional practice and procedure followed in other countries. Arrangement for short-term loan funds from abroad, in the interests of the commercial community when there is monetary stringency at home, is a proper function for banks, but not, *prima facie*, for the Government, to discharge. But there are particular reasons why official assistance is justified in the special circumstances of India. In the first place, there is no Central Bank in India, and the work of controlling remittance, exchange and currency, is at present carried on by the Government. Naturally, the best agency for raising loans abroad is that which controls all these cognate functions today. Secondly, even if the Imperial Bank of India, the premier banking institution of the country, which largely holds Treasury balances in India, comes into the London market, the step has to be taken with Government sanction and backing. Another reason, though not so strong, is that the Government already borrows by Bills in the interests of its own programme, and the scope of London borrowings for temporary purposes might well

be extended to include trade requirements too. A further reason of similar weight is that the Government's credit stands high in the London market, and a banking institution would have gradually to establish a tradition and build up its credit. But probably the most important argument for suggesting this course is that a part of the Indian Paper Currency Reserve is kept in London. This means that additional currency can be issued in India on the strength of an increased reserve built up by borrowings made in London to relieve the Indian money market in the active trade season. Even if only a few crores of rupees are thus placed at the disposal of the Indian market in the early months of the calendar year, they will serve to ease the situation considerably.

The two steps outlined above would go far to solve the chronic problem of high money rates in India in winter and early spring. Another great difficulty which remains to be faced in raising more funds locally is the problem of transferring funds to London, and the resulting exchange complications arising therefrom. So long as there are Home Charges of about £25 million to be paid annually in England and the necessity continues of spending large amounts

of money in order to buy capital goods abroad, the recurring problem of exchange will have to be faced. India is not peculiar in this respect. The exchanges of other countries in recent times have suffered great and varied fluctuations. As a result of the heavy post-war international indebtedness and the increased mobility of capital, exchange difficulties in European countries have increased a great deal. Our difficulties in this respect are not a fraction of what other countries are passing through. It looks, indeed, as if in future, stability of exchange will rather be an ideal than an actuality.

It is principally on account of this reason, and to avoid skimming the local money market, that foreign borrowings are sometimes preferable. Mr. Howard, of the Currency Department, stated in his cross-examination before the Banking and Currency Commission of 1913, that, in the preceding two or three years, more rupee loans could have been placed but were not raised, because the rupee balances were so high that it was not considered necessary to skim the market in that direction.[1] The External Capital Committee (1925)[2] also considered this aspect of

[1] Vol. I, Q. 8202.
[2] Para 19.

external loans. "In the case of Government and quasi-Government loans," they wrote, "the rate of interest should not be the sole consideration between an external and an internal loan, and the exchange position must always be allowed due weight." The ultimate remedy, for finding the necessary exchange, lies in increased production, encouragement of exports, and decrease in the imports of precious metals, the liquidation of external obligations, and the consequent diminution in the annual external debt charges. The necessity for these remedies is suggested by the fact that the interest on the direct sterling obligations of the Government of India, has more than doubled during the war and post-war periods, it being about £6 million in the last pre-war year and £13·12 million in the year 1927-28. But though conditions at the moment are abnormal, the problem is one which India shares with a number of other countries. Several countries have recently been very hard pressed in finding the necessary foreign exchange for meeting their external obligations. "All countries," wrote *The Times*,[1] "which are producers of primary products, such as foodstuffs

[1] February 8th, 1930.

and raw materials, are suffering from the decline in prices and from the resulting financial stringency, in varying degrees. Argentina, like Australia, is a large producer of grain and wool, and after a succession of prosperous years, is finding it difficult to export sufficient products to pay for her imports and to discharge the obligations of her foreign debt. As a consequence, the Peso has fallen to a discount of 10 per cent. Canada is also faced with the same difficulty, but in smaller measure, the discount of her currency being only about 1 per cent. The Australian pound has fallen to a heavier discount, and a sight draft of £100 on Australia is worth no more than £96-10-0 to the seller."

The last important difficulty to be taken into consideration is the constant anxiety as regards the maturity of short-term loans. That these 3, 5, 7 and 10-year Bonds are productive of more money than longer-term loans goes without saying. Being redeemable at an early date, moreover, the price of this paper does not vary greatly, and provides good security to bankers and others. But it is a bad principle to construct permanent works with money borrowed on short-term conditions. In addition to the heavy crop

of early maturities amounting to 200 crores of rupees in the funded form, the Government has unfunded obligations of over 200 crores of rupees which are repayable on demand; thus, almost $\frac{2}{5}$ths of the Government liabilities are held on short-term conditions. If at the time for the redemption of such obligations the money market is in the throes of a depression on account of one set of reverses or another, the Government may be placed in very great difficulties and may have to renew the obligations at more handsome rates of interest. The price of money had no doubt gone up as a result of the war, but it was principally owing to the pressure of heavy short-term maturing liabilities, contracted during the war, that the Government had to pay such high rates of interest on its immediately after-war borrowing and conversion operations. The only alternatives left were inflation of credit, and a high rate of interest to the private investor. In the general interests of the community, the Government adopted the latter course. But the best policy to adopt, in such circumstances, is to incur temporary debts in times of pressure and stringency, and then to substitute for this temporary debt a permanent debt as soon as market conditions make it possible to do so on reasonable terms.

This, in fact, was the essence of the financial policy of Sir Basil Blackett, when Finance Member of the Government of India. A large part of the Government's short-term obligations have been converted into fairly long-term loans during the period of his Finance Ministry.

SUMMING-UP

We are now able to summarize the position of the Indian money market in relation to the necessary supply of capital for public requirements. The next seven years can very reasonably be taken as the period needed for the purpose of taking stock and formulating a definite policy in three respects: (i) fresh borrowing, (ii) the conversion of early maturities in India, and (iii) the repayment of a part of the sterling debt falling due in connection with the direct loans of the Government of India and with the optional exercise of the railway purchases. The requirements under heads (ii) and (iii) amount to 200 crores of rupees or an average of 30 crores of rupees per annum. If we allot 20 crores of rupees annually for the fresh capital programme of the Central Government (for new capital expenditure only, purchase of old

railways being included in the figure of 200 crores of rupees) and 10 crores of rupees for the provinces, we require on an average 60 crores of rupees per annum in all. The average net yield on direct loans (total rupee loans *minus* conversions)[1] from the money market for the last ten years works out at 20 crores of rupees per annum. The last decade may be taken to be an average one including as it does years of heavy and of lean borrowings as well as being a period in which there were only conversions and no extra demand. If we assume that in the next seven years the money market in India will yield equally well at the same rate as it yielded in the past decade, the problem is to find resources for the supply of another 40 crores of rupees per annum.

Railway Reserves and the Debt Redemption scheme will provide 12 crores of rupees per annum. For the supply of the remaining 28 crores of rupees annually, however, we are definitely of the opinion that the Provident Funds, Post Office Savings Banks and Cash Certificates should be more intensively tapped. The Provident Funds yielded about 5 crores of rupees in 1926-27, Post Office Savings Banks over

[1] See table on p. 181.

3 crores of rupees in 1927-28 and the Cash Certificates about 8 crores of rupees in 1925-26. With a relaxation of the restrictions on the deposit of Provident Funds for investment with the Government, and the further extension of facilities for the small investor on the lines recommended in the previous chapter, it should not be difficult to obtain an additional 12 crores of rupees annually from these three sources.

We have advisedly refrained from suggesting a heavier demand on the open money market than 20 crores of rupees (the average of the last ten years), in order to exclude for the moment the question of the monetary stringency. But there is nothing to prevent the Government from raising more than this amount from the market in boom years or less in a bad year. So long as it is intended to carry through the policy over a whole period, the Government might even enter into some make-shift arrangements with London for temporary finance. But if the Government frames a bolder programme of capital expenditure than is assumed above, or the internal capital resources we have stressed should not yield up to expectations, the Government will have in corresponding measure to rely on the London money market.

In conclusion, we would wish to strike a note of optimism. The situation has many redeeming features. India has large hoards of the precious metals. " A recent enquiry carried out by an American Commission even suggests that the amount of the precious metals stored in India is equal to that held by the United States ; but in India this wealth is immobilized and rendered sterile by the habit of hoarding."[1] She has, however, created vast investments abroad in recent times; its dormant capital is gradually being released, as timidity lessens, and is being increasingly employed for the development and extension of industry. It is appearing in increasing quantities for investment in the Government loans. Sir Stanley Reed said before the Babington-Smith Committee that capital is available for investment in India "in almost embarrassing quantities." When a definite policy is adopted to draw it forth, when regular estimates of future demand are made, and the proper steps taken to secure the supply, the foreign indebtedness of India will disappear in no long period. "India is full of money and self-contained to supply all funds necessary for the expansion of its railways and

[1] " Report of the Liberal Industrial Enquiry," p. 376.

irrigation systems, and for the development of industries," asserted the Committee appointed in 1921 to enquire into the rehabilitation of Government securities. "We are of opinion that year after year, India will be able to spare increasing sums of money for the building of railways, canals and industries, and for provincial development. Unfortunately the money power of India is not properly mobilized. Money lies dormant in endless small hoards all over the country." It is the hope of the writer in submitting the suggestions contained in these pages, that they may contribute to the use of public credit as the most potent means of mobilizing—as indeed it is—the immobilized wealth of the country in order that the community may realize the greatest good for the largest number.

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